TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 238

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES OF E. E. COMBS WELL NO. 2, EXPRESS TRUST

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 11, 1935

CERTIORARI GRANTED OCTOBER 14, 1935

SUPREME COURT OF THE UNITED STATES

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vs.

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Docket No. 47099

APPEARANCES:

For Petitioners,
ROBT. N. MILLER, Esq.,
M. D. WILSON, Esq.,

For Respondent,
C. H. CURL, Esq.,

DOCKET ENTRIES:

1930

Jan. 20—Petition received and filed. Taxpayer notified. (Fee paid).

Jan. 21—Copy of petition served on General Counsel.

Mar. 10—Answer filed by General Counsel.

Mar. 17—Copy of answer served on taxpayer—assigned to Circuit Calendar.

1933

July 12—Hearing set at Long Beach, Calif., week of 9/25/33.

Sept. 25—Hearing had before E. H. Va[illegible]ossan, Division 9. Submitted on merits. Stipulation of facts filed. Briefs due 10/23/33—no exchange.

Oct. 10—Transcript of hearing 9/25/33 filed.

Oct. 21—Brief filed by taxpayer.

Nov. 18—Memorandum opinion rendered—E. H. Van Fossan, Division 9. Decision will be be entered under Rule 50.

Dec. 19—Notice of settlement filed by General Counsel.

Dec. 22—Hearing set Jan. 17, 1934, under Rule 50.

1934

Jan. 1—Consent to settlement filed by taxpayer.

Jan. 12—Decision entered—Ernest H. Van Fossan, Division 9.

Apr. 6—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error field by General Counsel.

Apr. 25—Proof of service filed by General Counsel.

May 22—Agreed statement of evidence lodged.

May 22—Praecipe with proof of service thereon filed.

May 23—Agreed statement of evidence approved and ordered filed.

June 5—Order enlarging time for transmission and delivery of record to June 23, 1934, entered. [1*]

United States Board of Tax Appeals.

Docket No. 47099.

E. E. COMBS and EDWARD EVERETT, Trustees of E. E. Combs Well No. 2 Express Trust,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION.

The above-named Petitioners hereby petition for a redetermination of the deficiency set forth by the

*Page numbering appearing at the foot of page of original certified Transcript of Record.

Commissioner in his notice of deficiency, IT:AR:C-5 MN 60D, dated December 18, 1929, and as a basis of their proceeding allege as follows:

I.

The Petitioners are E. E. Combs and Edward Everett, fiduciaries, Trustees of E. E. Combs Well No. 2 Express Trust, with their residence at 1400 Pacific Avenue, Long Beach, California.

II.

The notice of deficiency, a copy of which is attached and marked Exhibit "A", was mailed to the Petitioners on December 18, 1929.

III.

The taxes in controversy are corporation income taxes as follows: [2]

1925	$2,741.95
1926	4,627.27
	$7,369.22

IV.

The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Respondent erred in considering the trust as an association, subject to corporate income taxes.

(b) The Respondent is barred by the statute of limitations from issuing a deficiency or for assessing the proposed additional tax for the calendar year 1925.

V.

The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

(a) On February 6, 1925, E. E. Combs and Edward Everett caused a trust known as E. E. Combs Well No. 2 Express Trust, to be organized, naming themselves as trustees. A copy of the Declaration of Trust is attached hereto and made a part hereof.

(b) They caused an oil lease to be transferred to themselves as trustees.

(c) Certain persons were named as beneficiaries.

(d) The Trustees had sole and exclusive power to manage the trust property.

(e) The beneficiaries had no voice or control over the affairs of the trust.

(f) There were no officers or Board of Managers. [3]

(g) The trust simply developed a single parcel of real property into oil producing property, sold it, distributed the proceeds, and terminated its existence.

(h) The trust did not engage in business.

(i) The trust was formed and operated for the sole purpose of liquidating a single parcel of real property.

(j) The trust filed a fiduciary return for the calendar year 1925, on or before March 15, 1926.

(k) The time for assessing tax against the trust expired on March 15, 1929, under the Re-

venue Act of 1926 in effect for the calendar year 1925.

(l) The Respondent did not assess the proposed additional tax or issue the deficiency letter before March 15, 1929.

(m) The Respondent is now barred from asserting a deficiency or assessing tax for 1925.

WHEREFORE, the Petitioners pray that this Board may hear the proceeding in Los Angeles, California, and determine that the trust is not taxable as an association, and that the proposed additional tax for 1925 is barred by the statute of limitations.

ROBERT N. MILLER,
922 Southern Building,
Washington, D. C.
MELVIN D. WILSON,
819 Title Insurance Bldg.,
Los Angeles, California.
GEORGE M. THOMPSON,
505 Title Insurance Bldg.
Los Angeles, California. [4]

State of California,
County of Los Angeles.—ss.

E. E. Combs and Edward Everett, being duly sworn, depose and say:

That they are the Trustees of E. E. Combs Well #2 Express Trust, the Petitioner named in the foregoing Petition; that they are authorized to

verify the Petition; that they have read the same and that the statements therein made are true.

E. E. COMBS,
EDWARD EVERETT.

Subscribed and sworn to before me this 15th day of January, 1930.

(Seal) ZELDA M. COLBY,
Notary Public in and for the County of Los Angeles, State of California. [5]

N.P. 2

EXHIBIT "A"

TREASURY DEPARTMENT
WASHINGTON

(Seal)
Office of
Commissioner of Internal Revenue

Address reply to
Commissioner of Internal Revenue Dec. 18, 1929
And refer to
E. E. Combs Well #2, Express Trust,
c/o Melvin D. Wilson,
433 South Spring Street,
Los Angeles, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the years 1925 and 1926

discloses a deficiency of $7,369.22, as shown in the statement attached.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the inclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,

ROBT. H. LUCAS,
Commissioner.

By DAVID BURNET,
Deputy Commissioner.

Inclosures:
Statement
Form 866
Form 882
Form 7928-Rev. Dec. 1928. [6]

STATEMENT.

IT:AR:C-5
MN:60D

In re: E. E. Combs Well #2, Express Trust,
c/o Melvin D. Wilson,
433 South Spring Street,
Los Angeles, California.

Tax Liability

Years	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1925	$2,741.95	None	$2,741.95
1926	4,627.27	None	4,627.27
Totals	$7,369.22	None	$7,369.22

Reference is made to the report of the Internal Revenue Agent in Charge, San Francisco, California, and to your protest submitted under date of December 15, 1928.

You are advised that careful consideration has been accorded your protest in connection with the agent's findings and the report on conference held May 1, 1929, in the office of the Agent in Charge.

Your contention that the taxpayer is not taxable as an association is denied, since an examination of the trust indenture and the method of doing business indicates that the organization is an association as defined by Article 1504 of Regulations 69 and subject to tax as a corporation.

Your contention for the depletion allowance as shown by your books has been allowed in so far as

it does not exceed the limitations provided in Article 221 of Regulations 69.

Your contention has been allowed in determining the profit realized on the sale of the well during the year 1926 as reflected by your books.

Accordingly, the adjustments recommended by the agent have been approved by this office and the determination of your tax liability is as follows:

1925		
Net income as disclosed by books		$48,859.06
Additions:		
1. Excessive depletion:		
Amount claimed	$24,683.36	
Amount allowed	23,091.94	1,591.42
Total		$50,450.48
		[7]
Brought forward		$50,450.48
Deduction:		
2. Drilling expenses		27,358.54
Net income as adjusted		$23,091.94

Explanation of Adjustments

1. Depletion has been allowed in accordance with Article 221 of Regulations 69. Inasmuch as 27½% of the gross income exceeds 50% of the net income without the benefit of depletion the latter amount must be used as the depletion deduction.

2. This item represents intangible drilling expenses capitalized on the books which is an allow-

able deduction under Article 223 of Regulations 69, since the taxpayer has elected to expense such items.

Computation of Tax.

Net income	$23,091.94
Less:	
Exemption	2,000.00
Balance taxable at 13%	$21,091.94
Tax liability	$ 2,741.95
Previously assessed	None
Deficiency	$ 2,741.95

1926

Net income disclosed by books	$34,276.09

The net income as disclosed by books in the above amount has been approved by this office.

Computation of Tax

Net income	$34,276.09
Less:	
Exemption	None
Balance taxable at 13½%	$34,276.09

[8]

Tax liability	$4,627.27
Previously assessed	None
Deficiency	$4,627.27

A consent which will expire December 31, 1929 except as extended by the provisions of Section

277(b) of the Revenue Act of 1926 is on file for the year 1925.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1925 the Bureau will be unable to afford you an opportunity under the provisions of Treasury Decision 3867, to discuss your case before mailing formal notice of the determination as provided by Section 274(a) of the Revenue Act of 1926. It is, therefore, necessary at this time, in order to protect the interests of the Government, to issue this formal notice of deficiency. [9]

EXHIBIT "B"
MEMORANDUM OF FORMATION OF EXPRESS TRUST

DATED: February 6, 1925.

PURPOSE OF TRUST:

To finance and drill a well for production and sale of oil and other hydro-carbon substances under Oil and Gas Lease, dated July 24, 1924, recorded in Book 3443, page 170, Official Records, Los Angeles County, California, on Lot One (1) Block Eighteen (18), Athens, per map recorded in Book 8, page 146 of Maps, in said County.

IDENTIFICATIONS:

Hub Oil Company, a California corporation, as Assignor;

E. E. COMBS and EDWARD EVERETT (unless named individually) as TRUSTEES; and

ALL PERSONS who may own or acquire portions of the whole beneficial interest hereunder as BENEFICIARIES.

TERMS:

ASSIGNOR has assigned to Trustees all rights of Lessee under said lease, subject to a reservation in Assignor of .065 per cent of all oil, gas and other hydro-carbon substances which may be produced and saved under said lease, and to a reservation in favor of one Henry D. Smithson of a royalty interest in said lease equal to two one-hundredths (2/100) of the interest thereunder originally held by the Assignor.

ASSIGNOR will supply to Trustee, and at site, as and when required by them, adequate for purpose for use hereunder, and build and connect complete derrick for heavy rotary drilling to depth of 5000 feet, steam engines, boilers, control head, gas trap, and tanks. The Trustees shall pay the fair market value thereof to the Assignor out of the first proceeds accruing to the Trust from the sale of the products of such well, chargeable, pro rata, against all beneficial royalty interests hereunder, notwithstanding anything hereinafter said. Title to same shall vest in Trustees upon delivery, provided, however, that in the event of an abandonment or suspension of active drilling operations for a period of sixty (60) days the Hub Oil Company shall be ipso facto revested with title to said property and leasehold rights and may take possession of the same, free and clear from any and all claims or rights arising hereunder. [10]

SHERIDAN BAILES, an oil well driller, of Long Beach, California, has entered into an agreement in writing with E. E. Combs and Edward Everett to furnish, at the site, as and when needed for immediate and continuous drilling operations and for placing well on production, heavy rotary drilling outfit, adequate for drilling to depth of 5000 feet, and all necessary drill pipe and drilling material, and to superintend all drilling and production operations to the time when the well shall be *an* commercial production, in consideration of the covenants heretofore made to him of an interest in the royalties accruing from the operation of said well, equal to twelve per cent (12%) of the whole thereof, and under which agreement the trust estate is to pay all proper labor claims incurred in the drilling and production operations and is to also pay for all drilling and production materials which are not to be supplied by the said Hub Oil Company and the said Sheridan Bailes.

BENEFICIARIES: Each will forthwith deposit with Bank of Italy, (Trust Department), Long Beach Branch, the sum set opposite his name upon his execution hereof, to the credit of the Trustees, for use by them for the payment of labor and material claims and expenses of the trust.

TRUSTEES: (a) Will hold all property and property rights, the legal title to which may vest in them hereunder, IN TRUST, pursuant hereto; (b) Shall use all monies which may be so deposited by Beneficiaries to pay for labor, casing and

other materials incident to drilling and productions operations;

(c) Shall have and exercise all of the rights and powers of the Lessee under said Lease, except as herein provided;

(d) Shall manage and protect the trust property, pay trust debts, sell and contract for the sale of all products of the well, loan to and borrow money upon the credit of the trust at prevailing rates of interest for trust purposes; may pledge the whole beneficial interest hereunder for the repayment of the same, and may sell any unsold beneficial interests in the trust as they may deem best for trust purposes. Neither of the Trustees shall be individually liable for any act which may be done or left undone by him hereunder, except wilful misconduct. Trustees shall receive no compensation as such, but, after the well is on production, E. E. Combs shall act as Production Manager at a monthly salary of $250.00; and [11]

(e) It is specifically understood and agreed that, from time to time and pursuant to a permit or permits which may be issued by the Commissioner of Corporations, the beneficial interests of E. E. Combs, as hereinafter set forth, shall be first sold by the Trustees upon such terms and conditions as the said Commissioner may permit or direct, for the purpose of raising funds to pay any and all labor and material claims arising out of drilling operations and bringing one well on commercial production not otherwise provided for from funds

so to be deposited by the beneficiaries, and that no portion of any royalties accruing to the beneficiaries hereunder shall be used for the payment of any such labor and material claims until the said beneficial interests of E. E. Combs shall be so exhausted, but the production interests of the said E. E. Combs when so sold shall share equally in all benefits of the trust with the Beneficiaries.

All proceeds of sale of well products shall be paid direct to the Bank of Italy (Long Beach Branch) or to such other bank as the Trustees, or the survivor of them, may designate, to be distributed pursuant to the terms hereof, provided, however, that such bank shall pay all claims for labor and material incident to the operation and maintenance of the said well after the same shall be on production, which shall be certified to be correct by either of the Trustees.

BENEFICIAL INTERESTS:

The whole beneficial interest of this trust represents .71333 per cent of the gross production of the well, subject to the terms hereof. Beneficiaries shall be grouped and shall be paid their respective pro rata shares of production after a pro rata deduction for the payment of lawful trust obligations, as follows:

(a) Twenty-five per cent (25%) of gross production of the well, less pro rata deductions as herein provided for, to the Beneficiaries who may deposit monies as aforesaid for trust purposes, pro rata, proportional to their respective contributions;

(b) .44333 per cent of gross production, less like deduction and subject to all of the terms, to E. E. Combs; and,

(c) .02 per cent of gross production, less like deduction, to Edward Everett. [12]

In the event of resignation, permanent absence from Los Angeles County or refusal to act of any one of the Trustees, the remaining Trustee shall be vested with all of the rights, powers and titles of the Trustees and shall continue the operations of the trust as though he had been named in the first instance as the sole Trustee.

ISSUANCE OF BENEFICIAL CERTIFICATES:

Trustees shall forthwith apply to the Commissioner of Corporations for a permit to issue and sell Beneficial Interests hereunder. No such certificates shall be issued except pursuant to the terms of any such permit. Such certificates shall be in a form to be approved by the said Commissioner and may be impounded in Escrow until a well producing oil in commercial quantities shall be brought in on said land.

IN WITNESS WHEREOF, the parties hereto have affixed their hands and seals, the day and year above mentioned.

HUB OIL COMPANY,
(By) Geo. E. Black,
President.
(By) F. G. Delaney,
Secretary.
E. E. COMBS
EDWARD EVERETT
Trustees.

BENEFICIARIES.

Name.	Address.	Amount.	Per cent of Production.
George E. Kerrigan	211 So. Cal. Ave.	$1000	1%
T. H. Emerson	Hotel Virginia (Coronada, Calif.)	$1000	1%
A. H. Waddington	(1162 Orange Ave.)	$4000	4%
Joseph H. Bowen	624 West Ocean LB	$2000	2%
E. R. Harvey	1124 Cedar LB	$5000	5%
Fred G. Gamble	3915 Dalton LA	$2000	2%
Ferol Morgan	1208 E. 2nd St. LB	$2000	2%
F. W. Hicks	4049 Locust LB	$1000	1%
Chas. L. Jackson	4815 Vista Ave.	$1000	1%
R. G. Merrill	4820 Colorado	$1000	1%
Mrs. L. E. Burson	1835 Gardena	$3000	3%
Howard H. Lipsey	208 Pine St, LB	$1000	1%
W. D. Brown	2226 Elm	$1000	1%

[13]

State of California,
County of Los Angeles—ss.

On this 6th day of February, 1925, before me P. A. Yard, a Notary Public in and for said County, personally appeared E. E. Combs and Edward Everett, known to me to be the persons whose names are subscribed to the foregoing instrument as Trustees, and acknowledged to me that they executed the same.

WITNESS my hand and official seal.

(Signed) P. A. YARD
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: United States Board of Tax Appeals. Filed Jan. 20, 1930. [14]

[Title of Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits the allegations contained in paragraph III of the petition.

IV. Denies the allegations of error as set forth in paragraph IV of the petition, sub-paragraphs (a) and (b).

V. Admits that the petitioner was organized under a declaration of trust dated February 6, 1925, that the petitioner acquired, developed and disposed of certain oil producing properties, but denies all other allegations of fact contained in sub-paragraphs (a), (b), (c), (d), (e), (f), (g), (h), and (i) of said paragraph V of the petition. [15]

(j). Admits that the petitioner by one of the Trustees thereof executed a return for the calendar year 1925 on fiduciary return Form No. 1041 and caused the same to be filed in the office of the Collector for the 6th District of California on March 15, 1926.

(k). Denies the allegations of sub-paragraph (k) of paragraph V of the petition and alleges that prior to the expiration of three years after the filing of said return on, to-wit, January 4, 1929, both the petitioner and the Commissioner of Internal Revenue duly consented in writing to the assessment of the amount of any income taxes due under any return made by or on behalf of the petitioner for the year ended December 31, 1925, at any time on or before December 31, 1929, except that if a notice of a deficiency in tax should be sent to the petitioner by registered mail on or before said date then the time for making any assessment as aforesaid should be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter; that the deficiency letter from which the appeal herein was taken was duly mailed to the petitioner prior to December 31, 1929, to-wit, on December 18, 1929, and the Commissioner therein determined that the petitioner is taxable as an association.

(l). Admits that the proposed deficiency for the year 1925 has not been assessed. [16]

(m). Denies the allegations contained in sub-paragraph (m) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the taxpayers' petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
F. R. SHEARER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: United States Board of Tax Appeals. Filed Mar. 10, 1930. [17]

[Title of Court and Cause.]

Melvin D. Wilson, Esq., for the petitioners.
C. H. Curl, Esq., for the respondent.

MEMORANDUM OPINION.

VAN FOSSAN: The respondent determined deficiencies in income taxes for the year 1925 and 1926 in the amounts of $2,741.95 and $4,627.27, respectively. Petitioners protest that error was committed in considering it as an association taxable as a corporation rather than a trust taxable as such. This is the only question submitted for decision. The facts were all stipulated.

Under date of February 6, 1925, a trust was created "to finance and drill a well for production and sale of oil and other hydro-carbon [18] substances under oil and gas lease, dated July 24, 1924, renewed etc." Hub Oil Company was named as assignor and E. E. Combs and Edward Everett were

named trustees, all three parties signing the agreement. The memorandum provided that "all persons who may own or acquire portions of the whole beneficial interest hereunder" were beneficiaries.

The memorandum recites that the assignor had assigned to the trustees all rights of lessee under the lease subject to reservation to assignor of 6.5 per cent of all oil, gas and other hydro-carbons produced and subject to a reserved royalty of 2 per cent in another party.

The assignor agreed to supply the trustees certain equipment, one Sheridan Bailes had agreed in writing to furnish drilling equipment, other materials and superintend the operation of drilling the well in consideration of 12 per cent of the production, the trust to pay all labor claims and materials not otherwise provided for.

The "whole beneficial interest" in the trust was .71333 per cent of gross production. This interest was to be owned (a) 25 per cent, less deductions provided for, to beneficiaries who provide money for trust purposes, (b) .44333 per cent to E. E. Combs, (c) 2 per cent to Edward Everett.

The memorandum provided for the issuance of certificates of beneficial interest in approved legal form, such certificates to be held in escrow until a producing well is brought in. Thirteen persons were named as beneficiaries with the amount contributed and percentage owned by each, the amounts aggregating $25,000 and the percentage of ownership amounting to 25 per cent. [19]

The "Certificate of Beneficial Interest" recited that the party named was the holder of a beneficial interest under the trust agreement in the amount of a certain per cent of net production, and the same was transferable only upon the books of the trustees upon endorsement and surrender of the certificate.

The memorandum specified the duties and powers of the trustees as follows:

> (a) Will hold all property and property rights, the legal title to which may vest in them hereunder, IN TRUST, pursuant hereto;
>
> (b) Shall use all monies which may be so deposited by Beneficiaries to pay for labor, casing and other materials incident to drilling and productions operations;
>
> (c) Shall have and exercise all of the rights and powers of the Lessee under said Lease, except as herein provided;
>
> (d) Shall manage and protect the trust property, pay trust debts, sell and contract for the sale of all products of the well, loan to and borrow money upon the credit of the trust at prevailing rates of interest for trust purposes; may pledge the whole beneficial interest hereunder for the repayment of the same, and may sell any unsold beneficial interests in the trust as they may deem best for trust purposes. Neither of the Trustees shall be individually liable for any act which may be done or left undone by him hereunder, except wilful miscon-

duct. Trustees shall receive no compensation as such, but after the well is on production, E. E. Combs shall act as Production Manager at a monthly salary of $250.00, and

(e) It is specifically understood and agreed that, from time to time and pursuant to a permit or permits which may be issued by the Commissioner of Corporations, the beneficial interests of E. E. Combs, as hereinafter set forth, shall be first sold by the Trustees upon such terms and conditions as the said Commissioner may permit or direct, for the purpose of raising funds to pay any and all labor and material claims [20] arising out of drilling operations and bringing one well on commercial production not otherwise provided for from funds so to be deposited by the beneficiaries, and that no portion of any royalties accruing to the beneficiaries hereunder shall be used for the payment of any such labor and material claims until the said beneficial interests of E. E. Combs shall be so exhausted, but the production interests of the said E. E. Combs when so sold shall share equally in all benefits of the trust with the Beneficiaries.

All proceeds of sale of well products shall be paid direct to the Bank of Italy (Long Beach Branch) or to such other bank as the Trustees, or the survivor of them, may designate, to be distributed pursuant to the terms hereof, provided, however, that such bank shall pay all

claims for labor and material incident to the operation and maintenance of the said well after the same shall be on production, which shall be certified to be correct by either of the Trustees.

The provisions of the Declaration of Trust were carried out: The Hub Oil Company assigned the oil lease, mentioned in the Declaration of Trust, to the Trustees, and furnished the equipment specified in said Declaration of Trust, and received $15,000 therefor out of the proceeds from the sale of oil; Sheridan Bailes furnished the equipment and materials and services specified in the Declaration f Trust, and received 12 per cent of the gross production; Thirteen (13) persons contributed $25,000 to the Trustees in consideration of the issuance to them of 25 per cent of the net production of the well; E. E. Combs sold 9¼ per cent of the net production of the well, theretofore assigned to him, for $9,250, all of which he expended for drilling costs. He transferred 4.69 per cent of the net production to drillers and to an agent as a commission for obtaining the said lease.

A well was drilled in 1925 and produced oil throughout the remainder of 1925 and for a portion of the year 1926. In 1926, the Trustees sold [21] the lease. The trustees, in 1925 and 1926, currently distributed to the beneficiaries entitled thereto, the net proceeds from the sale of oil and from the sale of the lease. After the sale of the lease, in 1926, and the distribution of the moneys, the trust was terminated.

The beneficiaries never held a meeting. The trust had no office or place of business, no seal, no by-laws, and no official name. The trustees acquired only the one lease. They did not borrow any money or engage in any other business.

The respondent relies solely on Durfee Mineral Company, 7 B. T. A. 231. On examination, we find few points in common between the cases. In the Durfee case the creating instrument constantly refers to the organization as an "association" or "a joint stock association." The trustees were authorized to fill vacancies, select and appoint officers, conduct the business of the association, draw up and approve by-laws and amend such by-laws and the declaration of trust. "Voting privileges in the management of the business affairs of the Company" were delegated to the shareholders in the declaration of trust. Meetings of the shareholders were held. The company had a complex form of organization. The agreement provided for carrying on a general oil, gas and mineral production and marketing business in addition to selling or leasing land.

The present case presents a very different picture. There was but one, and that a very limited, enterprise authorized. The beneficiaries had no power or control. In none of the essential elements did the [22] petitioner resemble a corporation either in form or operation. The facts are comparable to those in Myers, Long & Co., 14 B. T. A. 460, where we ruled the petitioner not an association. This case has been cited with approval in many later decisions. See also Extension Oil Co., 16 B. T. A. 1028, affd. 47

Fed (2d) 65; Royal Syndicate, 20 B. T. A. 255; Ray Oil Co., 28 B. T. A. 1204.

Decision will be entered under Rule 50.

[Endorsed]: Entered Nov. 18, 1933. [23]

United States Board of Tax Appeals

Docket No. 47099

E. E. COMBS and EDWARD EVERETT, Trustees of E. E. COMBS WELL #2 EXPRESS TRUST,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the memorandum opinion of the Board entered November 18, 1933, the respondent herein on December 19, 1933, filed a notice of settlement and proposed computation, and the petitioner on January 1, 1934, having filed an acquiescence in the computation as made by the respondent, now therefore, it is

ORDERED AND DECIDED that there are no deficiencies in income tax for the years 1925 and 1926.

Enter:

[Seal] (Signed) ERNEST H. VAN FOSSAN

Member.

[Endorsed]: Entered Jan. 12, 1934. [24]

[Title of Court and Cause.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys Frank J. Wideman, Assistant Attorney General, Robert H. Jackson, General Counsel, Bureau of Internal Revenue, and Hugh Brewster, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

That this is a proceeding for review by the United States Circuit Court of Appeals for the Ninth Circuit of a decision of the United States Board of Tax Appeals entered on November 18, 1933, Docket No. 47099, redetermining no deficiencies in income taxes due from the petitioner below for the years 1925 and 1926. [25]

That your petitioner is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding office by virtue of the laws of the United States. That the respondents are individuals, and the duly appointed, qualified and acting trustees of the E. E. Combs Well #2 Express Trust, whose residence and place of business is Long Beach, California.

That the respondents herein filed their fiduciary returns of income for the years involved herein with the Collector of Internal Revenue for the Sixth District of California, within the jurisdiction of this Court.

That this petition for review is filed in pursuance of the provisions of Sections 1001-1003 of the Revenue Act of 1926, for the review of the decision of the United States Board of Tax Appeals rendered January 12, 1934, in accordance with the memorandum opinion of that Board entered on November 18, 1933.

II.

The only issue involved in this proceeding is whether the respondents were an association taxable as a corporation within the meaning of the Revenue Act of 1926.

On February 26, 1925, a trust was created to finance and drill an oil well for the production and sale of oil and other hydro-carbon substances. [26]

The trust was created and operated as follows:

The Hub Oil Company assigned an oil lease to two individuals as trustees. The assignor reserved only a right of .062 per cent of the production for himself and a royalty of 2/100 of the interest under the lease, which he originally held. The assignor was to supply the trustees with a site, derrick, engines, boilers, etc. for which the trustees were to pay the assignor their fair market value out of the first proceeds accruing to the trust. Title was to vest in the trustees upon delivery provided that if drilling operations were abandoned for a period of sixty days the Hub Oil Company was to be ipso facto revested with title to the leasehold and properties. The trustees employed a well driller on a 12% royalty basis who was to furnish certain machinery and drilling

materials and to superintend the drilling and production operations.

The trustees were to hold title to all property and property rights; to use all monies paid in by holders of beneficial interests to pay for labor, etc.; to exercise all the rights and powers of the lessee under the lease; to manage the trust property, pay trust debts, sell the products, loan to and borrow money upon the credit of the trust, and sell any unsold beneficial interest as they might deem best for trust purposes. The trustees were not liable for any act of omission or commission, except wilful misconduct, and they received no compensation. After the well was put on a production basis one of the trustees was to act as production manager at a monthly salary of $250.00. The trustees had authority to sell such [27] beneficial interests as was necessary to raise funds to pay any and all labor and material claims arising out of the drilling of one well. All the proceeds of sale of products was to be deposited in a bank to be selected by the trustees. In the event of the resignation, permanent absence from Los Angeles County, or refusal to act of one of the trustees the remaining trustee was vested with all the rights, powers and titles of the trustees and was to continue the operations of the trust. The trustees were to sell beneficial interests and issue certificates therefor in accordance with authority from the Commissioner of corporations.

The whole beneficial interest in the trust was .71333 per cent of gross production. The trust in-

strument provided for the issuance of certificates of beneficial interest under a permit to be issued by the Commissioner of Corporations. It was to be provided that such certificates might be impounded in escrow until a producing well was brought in. Beneficial certificates were issued to thirteen individuals, who contributed a total of $25,000.00, and who thereby became entitled to 25% of the production.

A well was drilled in 1925 and produced oil throughout the remainder of 1925 and for a portion of the year 1926. The trustees currently distributed to the beneficiaries entitled thereto the net proceeds from the sale of oil. The lease was sold in 1926, the net proceeds of the sale were distributed and the trust terminated. [28]

Your petitioner herein held respondents to be an association taxable as a corporation within the meaning of Section 2(a)(2) of Part IV of the Revenue Act of 1926 and Article 1504 of Regulations 69. and determined deficiencies in income taxes of $2,741.95 for the year 1925 and $4,627.27 for 1926.

The Board of Tax Appeals held that the respondents were not taxable as a corporation and that there is no deficiency in taxes for either of the years 1925 and 1926.

III.

Your petitioner desires to obtain a review of the aforementioned decision of the United States Board of Tax Appeals by the United States Circuit Court of Appeals for the Ninth Circuit.

Your petitioner's assignments of error are as follows:

(1) The Board of Tax Appeals erred in holding and deciding that there is no deficiency in income taxes due from these respondents for the years 1925 and 1926.

(2) The Board erred in holding and deciding that, under the facts stipulated before the Board respondents did not resemble a corporation either in form or operation.

(3) The Board erred in holding and deciding that the associating together of the holders of the beneficial interests of the respondents herein, together with their subscription to the fund for the liquidation of the lawful obligations of the trust, and cost of labor, materials and production operations and their [29] proportionate sharing of the profits therefrom, did not constitute them an association, taxable as a corporation.

(4) The Board erred in not holding and deciding that respondents constituted an association taxable as a corporation.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with the law and with the rules of the said Court and transmitted to the Clerk of the said Court for filing, and that appropriate action be taken to the end that the er-

rors complained of may be reviewed and corrected by said Court.

HB/mhk 4/6/34

FRANK J. WIDEMAN,
Assistant Attorney General.
(Signed) ROBERT H. JACKSON
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
HUGH BREWSTER
Special Attorney,
Bureau of Internal Revenue. [30]

VERIFICATION OF PETITION FOR REVIEW.

United States of America,
District of Columbia—ss.

Hugh Brewster, being duly sworn, says that he is a Special Attorney of the Bureau of Internal Revenue, and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(S) HUGH BREWSTER

Sworn and subscribed to before me this 6 day of ....., 1934.

HB/mhk 4/6/34

(S) GEORGE W. KREIS
Notary Public, District of Columbia.
My commission expires Nov. 16, 1937.

[Endorsed]: United States Board of Tax Appeals. Filed Apr. 5, 1934. [31]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Melvin D. Wilson,
c/o Miller, Chevalier, Peeler & Wilson,
819 Title Insurance Building,
Los Angeles, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of April, 1934, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 6th day of April, 1934.

(Signed) ROBERT H. JACKSON
General Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 10th day of April, 1934.

MELVIN D. WILSON
Attorney for respondents on review.

HB/mhk 3/6/34

[Endorsed]: United States Board of Tax Appeals. Filed Apr. 25, 1934. [32]

In the United States Circuit Court of Appeals
for the Ninth Circuit.

BTA No. 47099.

GUY T. HELVERING, Commissioner of
Internal Revenue,

Petitioner,

v.

E. E. COMBS and EDWARD EVERETT,
Trustees of E. E. Combs Well #2
Express Trust,

Respondent.

STATEMENT OF EVIDENCE

The following is a statement of the evidence in the above-entitled cause. This cause came on for hearing before the Honorable Ernest H. Van Fossen, Member of the United States Board of Tax Appeals, on September 25, 1933. Melvin D. Wilson, Esq., appeared for the petitioner, and E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, appeared for the respondent. All the facts were stipulated and are as follows:

I.

Attached hereto and marked Exhibit "A" is the Memorandum of Formation of Express Trust, under which this Trust was organized, and under which it functioned throughout its existence. [33]

II.

Attached hereto and marked Exhibit "B" is copy of the form of Certificate of Beneficial Interest, issued by the Trustees.

III.

That the provisions of the Declaration of Trust were carried out; The Hub Oil Company assigned the oil lease, mentioned in the Declaration of Trust, to the Trustees, and furnished the equipment specified in said Declaration of Trust, and received $15,000 therefor out of the proceeds from the sale of oil; Sheridan Bailes furnished the equipment and materials and services specified in the Declaration of Trust, and received 12 per cent of the gross production; thirteen (13) persons contributed $25,000 to the Trustees in consideration of the issuance to them of 25 per cent of the net production of the well; E. E. Combs sold 9¼ per cent of the net production of the well, theretofore assigned to him, for $9,250, all of which he expended for drilling costs. He transferred 4.69 per cent of the net production to drillers and to an agent as a commission for obtaining the said lease.

IV.

A well was drilled in 1925 and produced oil throughout the remainder of 1925 and for a portion of the year 1926. In 1926, the Trustees sold the lease. The Trustees, in 1925 and 1926, currently distributed to the beneficiaries entitled thereto, the net proceeds from the sale of oil and from the sale of the lease. After the sale of the lease, in 1926, and the distribution of the moneys, the Trust was terminated. [34]

V.

The beneficiaries never held a meeting. The Trust had no office or place of business; no seal;

no by-laws; and no official name. The Trustees acquired only the one lease. They did not borrow any money or engage in any other business.

VI.

The statute of limitations issue is waived or conceded by the taxpayer.

EXHIBIT "A"

MEMORANDUM OF FORMATION OF EXPRESS TRUST

Dated: February 6, 1925.

PURPOSE OF TRUST:

To finance and drill a well for production and sale of oil and other hydro-carbon substances under Oil and Gas Lease, dated July 24, 1924, recorded in Book 3443, page 170, Official Records, Los Angeles County, California, on Lot One (1) Block Eighteen (18), Athens, per map recorded in Book 8, page 146 of Maps, in said County.

IDENTIFICATIONS:

Hub Oil Company, a California corporation, as Assignor:

E. E. COMBS and EDWARD EVERETT (Unless named individually) as TRUSTEES; and, [35]

ALL PERSONS who may own or acquire portions of the whole beneficial interest hereunder as BENEFICIARIES.

TERMS:

ASSIGNOR has assigned to Trustees all rights of Lessee under said lease, subject to a reservation in Assignor of .065 per cent of all oil, gas and other hydro-carbon substances which may be produced and saved under said lease, and to a reservation in favor of one Henry D. Smithson of a royalty interest in said lease equal to two one-hundredths (2/100) of the interest thereunder originally held by the Assignor.

ASSIGNOR will supply to Trustees, and at site, as and when required by them, adequate for purpose for use hereunder, and build and connect complete derrick for heavy rotary drilling to depth of 5,000 feet, stem engines, boilers, control head, gas trap, and tanks. The Trustees shall pay the fair market value thereof to the Assignor out of the first proceeds accruing to the Trust from the sale of the products of such well, chargeable, pro rata, against all beneficial royalty interests hereunder, notwithstanding anything hereinafter said. Title to same shall vest in Trustees upon delivery, provided, however, that in the event of an abandonment or suspension of active drilling operations for a period of sixty (60) days the Hub Oil Company shall be ipso facto revested with title to said property and leasehold rights [36] and may take possession of the same, free and clear from any and all claims or rights arising hereunder.

SHERIDAN BAILES, an oil well driller, of Long Beach, California, has entered into an agree-

ment in writing with E. E. Combs and Edward Everett to furnish, at the site, as and when needed for immediate and continuous drilling operations and for placing well on production, heavy rotary drilling outfit, adequate for drilling to depth of 5,000 feet, and all necessary drill pipe and drilling material, and to superintend all drilling and production operations to the time when the well shall be on commercial production, in consideration of the covenants heretofore made to him of an interest in the royalties accruing from the operation of said well, equal to (12%) twelve per cent of the whole thereof, and under which agreement the trust estate is to pay all proper labor claims incurred in the drilling and production operations and is to also pay for all drilling and productions materials which are not to be supplied by the said Hub Oil Company and the said Sheridan Bailes.

BENEFICIARIES: Each will forthwith deposit with Bank of Italy, (Trust Department), Long Beach Branch, the sum set opposite his name upon his execution hereof, to the credit of the Trustees, for use by them for the payment of labor and material claims and expenses of the trust.

TRUSTEES: (a) Will hold all property and property rights, the legal title to which may vest in them hereunder, IN TRUST, pursuant hereto; [37]

(b) Shall use all monies which may be so deposited by Beneficiaries to pay for labor, casing and other materials incident to drilling and productions operations;

(c) Shall have and exercise all of the rights and powers of the Lessee under said Lease, except as herein provided;

(d) Shall manage and protect the trust property, pay trust debts, sell and contract for the sale of all products of the well, loan to and borrow money upon the credit of the trust at prevailing rates of interest for trust purposes; may pledge the whole beneficial interest hereunder for the repayment of the same, and may sell any unsold beneficial interests in the trust as they may deem best for trust purposes. Neither of the Trustees shall be individually liable for any act which may be done or left undone by him hereunder, except wilful misconduct. Trustees shall receive no compensation as such, but, after the well is on production, E. E. Combs shall act as Production Manager at a monthly salary of $250.00; and

(e) It is specifically understood and agreed that, from time to time and pursuant to a permit or permits which may be issued by the Commissioner of Corporations, the beneficial interests of E. E. Combs, as hereinafter set forth, shall be first sold by the Trustees upon such terms and conditions as the said Commissioner may permit or direct, for the purpose of raising funds to pay any and all labor and material claims arising out of drilling operations and bringing one [38] well on commercial production not otherwise provided for from funds so to be deposited by the beneficiaries, and that no portion of any royalties accruing to the beneficiaries hereunder shall be used for the payment of any such

labor and material claims until the said beneficial interests of E. E. Combs shall be so exhausted, but the production interests of the said E. E. Combs when so sold shall share equally in all benefits of the trust with the beneficiaries.

All proceeds of sale of well products shall be paid direct to the Bank of Italy (Long Beach Branch) or to such other bank as the Trustees, or the survivor of them, may designate, to be distributed pursuant to the terms hereof, provided, however, that such bank shall pay all claims for labor and material incident to the operation and maintenance of the said well after the same shall be on production, which shall be certified to be correct by either of the Trustees.

BENEFICIAL INTERESTS:

The whole beneficial interest of this trust represents .71333 per cent of the gross production of the well, subject to the terms hereof. Beneficiaries shall be grouped and shall be paid their respective pro rata shares of production after a pro rata deduction for the payment of lawful trust obligations, as follows: [39]

(a). Twenty-five per cent (25%) of gross production of the well, less pro rata deductions as herein provided for, to the Beneficiaries who may deposit monies as aforesaid for trust purposes, pro rata, proportional to their respective contributions:

(b) .44333 per cent of gross production, less like deduction and subject to all of the terms, to E. E. Combs; and,

(c) .02 per cent of gross production, less like deduction, to Edward Everett.

In the event of resignation, permanent absence from Los Angeles County or refusal to act of any one of the Trustees, the remaining Trustee shall be vested with all of the rights, powers and titles of the Trustees and shall continue the operations of the trust as though he had been named in the first instance as the sole Trustee.

ISSUANCE OF BENEFICIAL CERTIFICATES:

Trustees shall forthwith apply to the Commissioner of Corporations for a permit to issue and sell Beneficial Interests hereunder. No such certificates shall be issued except pursuant to the terms of any such permit. Such certificates shall be in a form to be approved by the said Commissioner and may be impounded in Escrow until a well producing oil in commercial quantities shall be brought in on said land. [40]

IN WITNESS WHEREOF, the parties hereto have affixed their hands and seals, the day and year above mentioned.

HUB OIL COMPANY,
(By) Geo. E. Black,
President.
(By) F. G. Delaney,
Secretary.
E. E. COMBS
EDWARD EVERETT
Trustee.

BENEFICIARIES

Name	Address	Amount	Per cent of Production
George E. Kerrigan	211 So. Cal. Ave.	$1000	.1%
T. H. Emerson	Hotel Virginia (Coronado, Calif.	$1000	1%
A. H. Waddington	(1162 Orange Ave.)	$4000	4%
Joseph H. Bowen	624 West Ocean LB	$2000	2%
E. R. Harvey	1124 Cedar LB	$5000	5%
Fred G. Gamble	3915 Dalton LA	$2000	2%
Ferol Morgan	1208 E. 2nd St. LB	$2000	2%
F. E. Hicks	4049 Locust LB	$1000	1%
Chas. L. Jackson	4815 Vista Ave	$1000	1%
R. G. Merrill	4820 Colorado	$1000	1%
Mrs. L. E. Burson	1835 Gardena	$3000	3%
Howard H. Lipsey	208 Pine St. LB	$1000	1%
W. D. Brown	2226 Elm	$1000	1%

[41]

"EXHIBIT B".

CERTIFICATE OF BENEFICIAL INTEREST.

E. E. Combs and Edward Everett, herein designated as Trustees, hereby certify that EDWARD EVERETT is the holder of a beneficial interest under that certain agreement for the formation of an express trust, made on the 6th day of February, 1925, and relating to the financing and drilling of a well for the production of oil and other hydro carbon substances on Lot 1, Block 18, Athens, Los Angeles County, California, which beneficial interest entitles the said Edward Everett to One-half of One per cent of the net production of any well which may be drilled upon the said lot under the said trust, subject to all of the agreements and conditions thereof.

The beneficial interest evidenced hereby is transferable only upon the books of the Trustees upon endorsement and surrender of this certificate.

Dated at Long Beach, California, this 17th day of April, 1925.

(Signed) E. E. COMBS
(Signed) EDWARD EVERETT
Trustees [42]

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the case is approved by the undersigned, Robert H. Jackson, General Counsel, Bureau of Internal Revenue, as attorney for the Commisioner of Internal Revenue.

(Signed) ROBERT H. JACKSON
General Counsel,
Bureau of Internal Revenue.

The foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, as attorney for respondent on review.

MELVIN D. WILSON
Attorney for Respondent on Review. [43]

Approved and Ordered Filed, May 23, 1934.

(S) ERNEST H. VAN FOSSAN

Member,

United States Board of Tax Appeals.

[Endorsed]: United States Board of Tax Appeals. Lodged May 22, 1934.

[Endorsed]: United States Board of Tax Appeals. Filed May 23, 1934.[44]

[Title of Court and Cause.]

PRAECIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue.

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board,

   (a) Petition, including annexed copy of deficiency letter.

   (b) Answer.

3. Memorandum opinion and decision of the Board.

4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

5. Statement of the evidence as settled and allowed.

6. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record not included in record.

7. This praecipe.

HB/mhk 4/28/34

(Signed) ROBERT H. JACKSON
General Counsel,
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 14th day of May, 1934.

MELVIN D. WILSON
Attorney for Respondent.

[Endorsed]: United States Board of Tax Appeals. Filed May 22, 1934. [45]

United States Board of Tax Appeals
Washington

Docket No. 47099

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

E. E. COMBS and EDWARD EVERETT,
Trustees of E. E. COMBS WELL # 2
EXPRESS TRUST,
Respondent.

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 45, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 13th day of June, 1934.

[Seal] B. D. GAMBLE
Clerk,
United States, Board of Tax Appeals.

[Endorsed]: No. 7523. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust, Respondents. Transcript of the Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed June 18, 1934.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

49 In United States Circuit Court of Appeals for the Ninth Circuit

No. 7523

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES, ETC., RESPONDENT

Before WILBUR and GARRECHT, C. J. J., and CAVANAH, D. J.

Order of submission

January 24, 1935

Ordered petition to review in above cause argued by Mr. Lucius A. Buck, Special Assistant to the Attorney General, counsel for petitioner, and by Mr. Dana Latham, counsel for respondent, and submitted to the court for consideration and decision.

50 In United States Circuit Court of Appeals

[Title omitted.]

Order directing filing of opinion and filing and recording of judgment

By direction of the court, ordered that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

51 In United States Circuit Court of Appeals for the Ninth Circuit

No. 7523

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES OF E. E. COMBS WELL NO. 2, EXPRESS TRUST, RESPONDENTS

Upon Petition to Review an Order of the United States Board of Tax Appeals

Before WILBUR and GARRECHT, Circuit Judges, and CAVANAH, District Judge

Opinion

WILBUR, *Circuit Judge:*

April 11, 1935

The Commissioner of Internal Revenue determined a deficiency in the tax of the respondents for the years 1925 and 1926 amounting to $7,369.22. This deficiency it appears was assessed upon the theory

that the respondents were acting as an association and therefore taxable under the Revenue Act of 1926, §2 (a), 44 Stat. 9, as interpreted by Treasury Regulations 69, promulgated under that act, arts, 1502, 1504. The Board of Tax Appeals reversed the decision of the Commissioner upon the ground that the respondents were not an association and the Commissioner brings this petition to review the act of the Board of Tax Appeals. The question as to whether or not organizations are taxable associations under the revenue act is one that has been frequently before the courts and is not free from difficulty. The various decisions have been collected and discussed in a number of recent cases, Reinecke v. Kaempfer, 72 F. (2d) 469; Twin Bell Oil Syndicate v. Helvering, 70 F. (2d) 402; Hecht v. Malley, 265 U. S. 144; Commissioner v. Brouillard, 70 F. (2d) 154; Burk-waggoner Oil Ass'n v. Hopkins, 269 U. S. 110. We think it
52 unnecessary to enter into an extended discussion of the various decisions of the courts of appeals dealing with the question, or to attempt to establish the proper rule for determining the question of tax liability. The tendency of the recent cases is to deal with the facts of the particular case rather than to attempt to define the term "Association" more precisely than is done by the regulations of the Treasury Department. So stated Judge Sparks, speaking for the Circuit Court of Appeals in the Seventh Circuit in Tyson v. Com'r., 68 F. (2d) 584 (in February 1934), as follows:

"The trend of these decisions seems to be to look to the actual activities of the entity first, rather than to its form or possible powers."

So also is the statement of Judge Alschuler, speaking for the same court in Reinecke v. Kaempfer, supra (in June 1934), where he said:

"We are satisfied that the similitude referred to is not in those essentials which distinctly stamp the entity as a corporation, but rather in the business carried on and the manner of its transaction."

Judge Wilson, speaking for the Circuit Court of Appeals for the First Circuit, dealt with this matter in a recent opinion (Commissioner v. Kelly, 74 F. (2d) 71) saying,

"The courts have also said that in determining whether a trust is taxable as a corporation, substance rather than form is to be regarded; but each case must be determined on its own facts."

In the latter case (Commissioner v. Kelly, supra) Judge Wilson reviewed the decisions on this subject and deduced the conclusion that,

"To constitute a trust an association, and taxable as a corporation, there must be a body of persons associated together who are (1) actually carrying on business for profit, and (2) under the usual forms and procedure of corporations. Both conditions must be present."

53 In Twin Bell Oil Syndicate v. Helvering, 70 F. (2d) 402, we considered the proper interpretation of the statute and rules of the Treasury Department concerning the taxability of as-

sociations there involved and held that the Twin Bell Oil Syndicate was such an association. Judge Sawtelle, speaking for the court said,

"• • • we are impelled to the conclusion that the taxpayer was engaged in business; that its organization was of a quasi corporate character, and that as a consequence, it was an 'association' and should be taxed as a corporation under the provisions of the Revenue Act of 1926 and the Treasury Regulations promulgated thereunder."

This case was reversed by the Supreme Court on other grounds (December 3, 1934), 55 Sup. Ct. 174, 75 L. Ed. 183.

It is agreed that one of the tests for determining whether or not a trust is so organized as to constitute an association within the meaning of the taxing laws is whether or not the trustees are authorized to conduct business and do so. Inasmuch as the purpose of the act is to treat associations, corporations, joint-stock companies and insurance companies on a basis distinct and separate from that applicable to trusts or copartnerships, it is clear that while a trust may be organized so that the trustees can do business, their powers, duties, obligations and methods of doing business and the relationship of the trustees to the beneficiaries, must in some degree correspond to the similar duties and obligations of directors and stockholders of a corporation in order to make the trust taxable as an association. The first test as to whether or not the trust is one to do business as distinguished from one for merely holding investments for the beneficiaries and for the transaction only of the incidental business essential to holding and maintaining the trust property so as to realize an income therefrom is a relatively simple one, while the second test as to whether or not the trust is so organized as to constitute it a quasi corporation or association because of its methods of doing business and its organization therefor, is a more difficult one involving more detailed consideration of the plan of operation. As we understand the respondents, they do not question that the trust therein was doing business, but they contend that they do not meet the second test. They claim that they "were neither organized nor did they operate in any sense of the word along
54 the modes, methods, and manners ordinarily employed by corporations." With these contentions in mind, we will state more in detail the facts concerning the trust and the business conducted thereunder by the respondents.

The Hub Oil Company was the owner of a certain oil lease on a town lot of Athens, California, which lease was subject to a royalty reserved to the lessor. E. E. Combs and Edward Everett were desirous of developing the property in conjunction with the Hub Oil Company and Sheridan Bailes, an oil-well driller. Under date of February 6, 1925, a "Memorandum of Formation of Express Trust" was drawn up and signed by the parties, which had for its purpose "to finance and drill a well for production and sale of oil and other hydrocarbon substances" under the oil lease owned

by the Hub Oil Company. The trust agreement recited that the Hub Oil Company, as assigner, had transferred to E. E. Combs and Edward Everett, as trustees, all its right as lessee under the lease, subject to a reservation of a percentage of the oil, gas, and other hydrocarbon substances which may be produced and saved under said lease. The assignor also agreed to furnish a derrick for drilling an oil well, which was to be paid for out of production. The trust agreement also recited that a contract had been entered into by Combs and Everett with Bailes for sinking a well. By the terms of the contract Bailes was to furnish the necessary tools for drilling the well and to superintend all drilling and production operations for a percentage of the oil produced. Combs and Everett as trustees, were to pay for the cost of the labor, for the oil-well casing and for the incidental supplies needed in sinking the well. To proceed with the development of the property it was only necessary to secure the money to pay for the labor costs, the oil-well casing and incidental supplies. In order to secure this money the beneficial interest in the trust was divided into shares and twenty-five shares, each representing one percent of the production less deduction for expenses, were sold for $1,000 each. The trust memorandum stated that the "whole beneficial interest of this trust represents .71333 percent of the gross production of the well, subject to the terms hereof." This interest was to be owned as follows: (1) 25% by beneficiaries providing money for trust purposes; (2) .44333 percent by E. E. Combs; and (3) .02 percent by Edward Everett. By
55 the terms of the trust agreement E. E. Combs was required to sell such portion of his beneficial interest as was needed, over and above the amounts received from the twenty-five shares, for the completion of the well. Upon the completion of the well it was provided that the moneys derived from the sale of oil produced therefrom were to be paid into a bank named in the trust agreement which was to disburse the moneys in payment of the operating expenses and distribute the balance to the beneficiaries in proportion to their beneficial interest. The trust was terminated after the well had been producing for two years by the sale of the interest of the trustees and the distribution of the proceeds to the beneficiaries in accordance with their several interests.

The trust agreement gave the two trustees large powers over the property of the trust similar to those of a board of directors of a corporation, but they had no seal, no principal place of business. There was no provision in the trust agreement for meetings of the trustees or the beneficiaries. The latter had no control over the trustees and no participation in the selection of the trustees or their successors. As above stated, the business necessary to develop the lot for oil production had been largely completed by Combs and Everett before the trust was formed. The sale of the twenty-five shares (25% of the beneficial interest) was required to secure the needed capital for drilling the well. Thereafter the trustees had little to do except to arrange for the care of the well and the marketing of the

oil. There was no authority in the trust agreement for conducting a general oil development or oil-producing business or to drill more than one well under the lease held by the trustees.

The respondents point out that the trust agreement made no provision for the election of trustees annually or otherwise. Upon the death, resignation, or refusal of one to act, the other was authorized to act alone. There were no corporate officers, no bylaws, no corporate or association name. While the question involved is a close one not free from difficulty we conclude that the Board of Tax Appeals was right in holding that the organization was not an association within the meaning of the Revenue Act but rather that it was a trust, taxable as such. Coleman-Gilbert Associates v. Commissioner, decided Feb. 27, 1935, C. C. A. 1, Prentice-Hall Federal Tax Service, 1935, p. 889.

Order affirmed.

(Endorsed:) Opinion. Filed April 11, 1935. Paul P. O'Brien, Clerk.

56 In United States Circuit Court of Appeals for the Ninth Circuit

No. 7523

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES, RESPONDENTS

Judgment

Filed April 11, 1935

Upon petition to review an Order of the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was duly submitted:

On Consideration Whereof, It is now here ordered and adjudged by this court that the Order of the said Board of Tax Appeals in this cause be, and hereby is, affirmed.

[File endorsement omitted.]

57 [Clerk's Certificate to foregoing transcript omitted in printing.]

58 Supreme Court of the United States

Order allowing certiorari

Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, and the case is assigned for argument immediately following No. 108.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File No. 39792. U. S. Circuit Court of Appeals, Ninth Circuit. Term No. 238. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust. Petition for a writ of certiorari and exhibit thereto. Filed July 11, 1935. Term No. 238 O. T. 1935.

U. S. GOVERNMENT PRINTING OFFICE: 1935

FILE COPY

No. 239

In the Supreme Court of the United States

October Term, 1935

Guy T. Helvering, Commissioner of Internal

E. B. Crocker and Edward Dickey, Executors of
the Estate of Mary Wolf, No. 2, Deceased

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH
CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES OF E. E. Combs Well No. 2, Express Trust

---

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above-entitled cause on April 11, 1935.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 20–26) is unreported. The opinion of the Circuit Court of Appeals is reported in 76 F. (2d) 682.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 11, 1935. The jurisdiction of

this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the trust here involved was an association and as such taxable as a corporation.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> SEC. 2. (a) When used in this Act—
>
> * * * * * *
>
> (2) The term "corporation" includes associations, joint-stock companies, and insurance companies.
>
> (U. S. C. App., Title 26, Sec. 1262.)

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

> ART. 1502. *Associations.* — Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. * * *

ART. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341–347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

STATEMENT

The facts were stipulated (R. 34–43) and may be summarized as follows:

The trust here involved was created by a "Memorandum of Formation of Express Trust" (R. 36–

41), executed on February 6, 1925. The purpose as stated therein was to finance and drill a well for the production and sale of oil and other hydrocarbon substances under an oil and gas lease dated July 24, 1924. This instrument was signed by the Hub Oil Company, as assignor, and by E. E. Combs and Edward Everett, as trustees. It stated that there was assigned to the trustees all rights of a lessee under the lease subject to a reservation to the assignor of 6.5% of all oil, gas and other hydrocarbons produced, and subject also to a reserved royalty of 2% to another person. The assignor agreed to supply certain drilling equipment at its fair market value, and one Sheridan Bailes agreed to furnish other equipment and to superintend all drilling and production operations for a consideration of 12% of the production. The trust was to pay all labor claims and for materials not supplied by the Hub Oil Company or by Bailes. (R. 37–38.)

The "whole beneficial interest" in the trust was to be 71⅓% of the gross production of the well. This interest was to be owned as follows: (1) 25% less certain deductions for trust obligations to beneficiaries providing money for trust purposes, (2) 44⅓% to E. E. Combs less like deductions, and (3) 2% to Edward Everett also less such deductions. The agreement provided for the issuance of certificates of beneficial interest transferable only upon the books of the trust when endorsed and surrendered. (R. 40–41, 43.)

The trustees were given the following powers and duties: (1) To hold all property, the legal title to which might vest in them under the trust, (2) to use all monies which were to be deposited by the beneficiaries to pay for labor and materials incident to the drilling and producing operations, (3) to exercise all the rights of a lessee under the lease except as otherwise provided, (4) to pay the trust debts, (5) to manage and protect the trust property, (6) to sell and contract for the sale of all products of the well, (7) to loan and borrow money upon the credit of the trust for trust purposes, and (8) to sell any remaining beneficial interest in the trust as they might deem best for trust purposes. Combs was also to act as Production Manager when the well started producing. (R. 38–39.)

The trust agreement also provided that the beneficial interests of E. E. Combs could be sold by the trustees for the purpose of raising funds to pay the expenses incident to producing oil from one well and not otherwise provided for from funds to be deposited by the beneficiaries, and that no portion of any royalties accruing to the beneficiaries should be used for the payment of any such expenses until the beneficial interests of E. E. Combs were exhausted. (R. 39–40.)

The provisions of the trust agreement were carried out and the Hub Oil Company received $15,000 out of the proceeds of the oil. Sheridan Bailes received 12% of the production as agreed. (R. 35.)

Thirteen persons contributed a total of $25,000 (R. 42) and received certificates entitling them to 25% of the net production of the well. E. E. Combs sold 9¼% of the net production of the well, which had been assigned to him, for $9,250 and spent all of the money received in drilling operations. (R. 35.)

A well was drilled in 1925 and produced oil throughout the remainder of that year and during 1926 until the trustees sold the lease. The trustees distributed the amount received from the sale of the lease to the beneficiaries and had also currently distributed, during 1925 and 1926, the amounts received from the sale of oil. After the lease was sold and the proceeds distributed, the trust was terminated. (R. 35.)

During its existence the trust had no office or place of business, no seal, no by-laws, and no official name. The trustees acquired only the one lease, and did not borrow any money or engage in any other business. During such time the beneficiaries held no meetings. (R. 35–36.)

The Commissioner held that the trust was an association taxable as a corporation and determined deficiencies in income taxes for the years 1925 and 1926 in the amounts of $2,741.95 and $4,627.27, respectively. (R. 8.) The Board of Tax Appeals decided that the trust was not so taxable and its decision was affirmed by the Circuit Court of Appeals.

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that the trust was not taxable as an association.

REASONS FOR GRANTING THE WRIT

1. The question presented here is one about which there is much confusion and as it is involved in many cases now pending in the courts and in the Bureau of Internal Revenue, it is a question of general importance. In deciding the instant case the Circuit Court of Appeals called attention to the frequency with which this question has been presented to the courts and stated it is a close one and not free from difficulty. A similar view was recently taken in *Coleman-Gilbert Associates* v. *Commissioner*, 76 F. (2d) 191 (C. C. A. 1st), in which the court there stated that (p. 193):

> There are numerous decisions of the Board of Tax Appeals and Circuit Courts of Appeals in review, without laying down any definite line of demarkation between an association and a pure trust. * * * In any event, *the decisions are seemingly in a hopeless state of confusion.* * * * (Italics supplied.)

The existing confusion in these cases extends not only to decisions by courts of different circuits but to decisions by the same courts. For instance, the decision in the instant case is not consistent with the earlier decision by the Circuit Court of Appeals for the Ninth Circuit in *Morrissey* v. *Commissioner*,

74 F. (2d) 803. The taxpayer's petition for certiorari in the *Morrissey* case was granted on May 13, 1935, No. 17, October Term, 1935.

A petition for certiorari was filed on behalf of the Commissioner in the case of *Coleman Gilbert Associates, supra,* on May 27, 1935, Nos. 78 and 79, October Term, 1935.

2. The decision in the instant case is in substantial conflict with that of the Circuit Court of Appeals for the Seventh Circuit in *Swanson* v. *Commissioner,* 76 F. (2d) 651, in which writ of certiorari was applied for June 7, 1935, No. 108, October Term, 1935, and the Government is not opposing the taxpayer's petition.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

JULY 1935.

U. S. GOVERNMENT PRINTING OFFICE: 1935

FILE COPY

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CHARLES ELMORE

No. 238

In the Supreme Court of the United States

OCTOBER TERM, 1935

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES OF E. E. COMBS WELL NO. 2, EXPRESS TRUST

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 238

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES OF E. E. COMBS WELL NO. 2, EXPRESS TRUST

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 20–26) is unreported. The opinion of the Circuit Court of Appeals (R. 50) is reported in 76 F. (2d) 682.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 11, 1935 (R. 53). A petition for a writ of certiorari was filed July 11, 1935, and

was granted October 14, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the trust here involved was an association within the meaning of Section 2 (a) (2) of the Revenue Act of 1926.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> SEC. 2. (a) When used in this Act—
>
> * * * * *
>
> (2) The term "corporation" includes associations, joint-stock companies, and insurance companies.
>
> * * * * *
>
> [U. S. C., Title 26, Sec. 1696.]

Treasury Regulations 69:

> ART. 1502. *Association.*—Associations and joint-stock companies include associations, common-law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has in-

vested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 2.

ART. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341–347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

STATEMENT

The facts as stipulated and as found by the Board of Tax Appeals may be summarized as follows:

Under date of February 6, 1925, the Hub Oil Company, as a holder of an oil and gas lease in California, and E. E. Combs and Edward Everett, as trustees, signed a "Memorandum of Formation of Express Trust" for the purpose of financing and drilling a well for the production and sale of oil and other hydrocarbon substances. (R. 36.)

The Hub Oil Company assigned all of its rights under the lease subject to a reservation to it of 6.5% of all oil, gas and other hydrocarbons produced and to a reserved royalty of 2% to one Henry D. Smithson. (R. 37.)

The Hub Oil Company (hereinafter called the assignor) agreed to supply certain drilling equipment for which it should be reimbursed out of the first proceeds from the sale of oil, with the proviso that the assignor might repossess the equipment in the event of the abandonment or suspension of active drilling operations for more than sixty days. (R. 37.)

The agreement stated that one Sheridan Bailes, an oil well driller, had already contracted with Combs and Everett to furnish other equipment and superintend drilling and producing operations in consideration of the receipt of a 12% royalty. The trust estate was to pay all proper labor claims incurred in drilling operations and for all drilling

and production materials not supplied by the assignor or Sheridan Bailes. (R. 37–38.)

The "whole beneficial interest" in the trust was to be 71⅓% of the gross production of the well. This interest was to be owned as follows: (1) 25% less certain deductions for trust obligations to beneficiaries who should provide money for trust purposes, (2) 44⅓% less like deductions to E. E. Combs and (3) 2% to Edward Everett, also less such deductions. (R. 40–41.)

The agreement provided for the issuance of certificates of beneficial interest transferable only upon the books of the trust when endorsed and surrendered. (R. 41, 42–43.) A list of the subscriptions appears in the record (p. 42).

The beneficial interests of Combs could also be sold by the trustees for the purpose of raising funds to pay the expenses which were not met by the funds of the beneficiaries. (R. 39.)

The trustees were given the power to hold all property, the legal title to which might vest in them under the trust; to use moneys deposited by beneficiaries to pay for labor and materials incident to drilling and producing; to exercise all rights of a lessee under the lease except as otherwise provided; to pay the trust debts, manage the trust property, borrow money, sell the products of the well and sell any remaining beneficial interest. They were not to be liable for any act except wilful misconduct. (R. 38–39.)

Combs was also to act as production manager when the well started producing. (R. 39.)

All proceeds of the sale of well products were to be paid direct to the Bank of Italy (or some other bank designated by the trustees) to be distributed among the beneficiaries, after the bank had paid claims for labor and materials which had been approved by the trustees. (R. 40.)

The provisions of the trust were carried out, a well was drilled in 1925 and produced oil through 1925 and for a portion of the year 1926 until the lease was sold and the trust terminated. (R. 35.)

The assignor furnished the required equipment and received $15,000 therefor out of the first oil produced and sold. Bailes received 12% of the gross production and the thirteen beneficiaries who contributed $25,000 to the trust received 25% of the net production. Combs sold 9¼% of the interest assigned to him for $9,250, which was expended on drilling costs. He transferred 4.69% of the net production to drillers and to an agent as a commission for obtaining the lease. (R. 35.)

The beneficiaries never held a meeting. The trust had no office or place of business, no name, seal, or by-laws. The trustees acquired only the one lease and did not borrow money or engage in any other business. (R. 35–36.)

The Commissioner classified the trust as an association for the years 1925 and 1926 and determined deficiencies of $2,741.95 and $4,627.27. (R. 10.)

The Board of Tax Appeals reversed the Commissioner's determination and the Circuit Court of Appeals sustained the Board.

ARGUMENT

The sole question in this case is whether the trust involved is an association within the meaning of Section 2 (a) (2) of the Revenue Act of 1926.

The same general question is involved in *T. A. Morrissey and James M. O'Brien, Trustees of an express trust known as the Western Avenue Golf Club* v. *Helvering*, No. 17, October term, 1935, in *Helvering* v. *Coleman-Gilbert Associates*, Nos. 78 and 79, October term, 1935, and in *Joseph E. Swanson, etc.* v. *Helvering*, No. 108, October term, 1935.

We think that no useful purpose will be served by repeating herein the arguments made in the Government's briefs in the first two of those cases, which we incorporate herein by reference.

Our position is that a trust which is doing business is an association within the meaning of the statute, regardless of whether it employes a seal, by-laws, formal meetings of the trustees analogous to directors' meetings and other devices of a corporation.

The trustees in this case did not argue before the court below that they were not doing business. The court below said (R. 52):

> As we understand the respondents they do not question that the trust herein was doing business, but they contend that they do not

meet the second test. They claim that they "were neither organized nor did they operate in any sense of the word along the modes, methods and manners ordinarily employed by corporations."

We understand, therefore, that the trustees have conceded that the trust was doing business.

The same court that decided this case has held in other cases that the doing of business is sufficient to characterize a trust as an association. *Trust No. 5833, Security-First Nat. Bank* v. *Welch*, 54 F. (2d) 323, certiorari denied, 286 U. S. 544; *Sloan* v. *Commissioner*, 63 F. (2d) 666; *Twin Bell Oil Syndicate* v. *Helvering*, 70 F. (2d) 402, reversed on other grounds, 293 U. S. 312. For reasons stated in the briefs in the *Morrissey* case and the *Coleman-Gilbert Associates* case, we think that the earlier opinions of that court express the better view.

If more is required, however, we think that the trust here involved resembled a corporation in matters of substance. It had certificates of beneficial interest which could be transferred without affecting the continuity of the trust. The trustees had no personal liability for obligations of the trust, and there is nothing to indicate that creditors could look to anything other than the trust funds for payment of their obligations. The business of the trust was conducted by the trustees for the beneficiaries. Hence, there were continuity, centralized control, and limited lia-

bility which are the distinguishing features of a corporation under the decision of this Court in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107.

We submit that the trust should be treated as an association.

CONCLUSION

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

STANLEY REED,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
HELEN R. CARLOSS,
Special Assistants to the Attorney General.

OCTOBER 1935.

U. S. GOVERNMENT PRINTING OFFICE: 1935

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1935.

No. 238.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

LATHAM, WATKINS & BOUCHARD,
DANA LATHAM,
Title Guarantee Bldg., 411 W. Fifth St., L. A.,
MILLER, CHEVALIER, PEELER & WILSON,
MELVIN D. WILSON,
Title Ins. Bldg., 433 S. Spring St., Los Angeles,
Attorneys for Respondents.

Parker, Stone & Baird Co., Law Printers, Los Angeles.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1935.

No. 238.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Respondents herein respectfully submit that the petition for a writ of certiorari heretofore filed should be denied because:

1. There is no real confusion among the various Circuit Courts with respect to the issue herein involved, namely, *when is a trust taxable as an association.*

2. There is no real conflict between the various Circuit Courts as to the law properly applicable to

the issue above referred to. At most, said Circuit Courts differ only in the results arrived at from the application of admittedly proper rules of law to particular sets of facts. Such differences *in result* are frequent and inevitable.

3. The Circuit Court of Appeals for the Ninth Circuit was correct in affirming the decision of the United States Board of Tax Appeals holding that the respondents herein were not taxable as an association for the calendar years 1925 and 1926.

Issue Involved.

Whether the express trust of which the respondents herein were trustees constituted an association taxable as a corporation for the calendar years 1925 and 1926.

Before the Circuit Court of Appeals petitioner herein contended that in order to render said trust so taxable *it was only necessary that it be engaged in business* as that term is ordinarily understood. The lower court in finding that said trust was not taxable as an association held that in addition to doing business *it was essential that it be organized and operated along the forms, modes, and methods of a corporation, which situation did not here exist.*

The Facts.

While the facts as stated by petitioner herein are substantially correct, we prefer to restate them in a slightly different fashion, employing in general for that purpose the statement of facts appearing in respondents' brief before the Circuit Court of Appeals:

1. The Hub Oil Company was the owner of a certain oil lease subject to a royalty reserved to the lessor. [R. 35, 40.]

2. One Combs, acting apparently with one Everett, desired to develop the property in conjunction with the Hub Oil Company and one Bailes. [R. 37-41.]

3. Prior to the creation of the trust herein involved Combs and Everett entered into an agreement with Bailes whereby Bailes was to furnish drilling equipment, drill pipe, drilling materials, and *to superintend the drilling and production operations until the well should be on commercial production.* For this Bailes was to receive 12% of the gross proceeds of the well. [R. 37.]

4. The Hub Oil Company was to furnish a derrick, boilers, gas trap, etc. In case a producing well was brought in, the Hub Oil Company was to be paid the fair value of the property furnished. In case the project was unsuccessful, the Hub Oil Company had the right to remove the equipment from the property. As a matter of fact, from production the Hub Oil Company did receive for the equipment $15,000. In addition the company reserved a percentage of the future gross production of the well. [R. 35, 37.]

5. All the elements necessary in order to complete a producing well were thus provided for, except the cost of labor, casing, and incidentals. These were to be furnished in one or both of two ways:

(a) Percentage interests in future gross production of the well less *pro rata* expense deductions were to be sold. [R. 38.]

(b) Such portion of the percentage of gross production retained by Combs personally as might be

necessary was to be later sold by Combs in case the proceeds of the first sales of beneficial interests were insufficient. The proceeds of such sales were to be used for trust purposes and were not to revert to Combs personally. In effect, Combs was required to dispose of his entire personal interest and donate the proceeds back if necessary in order to prove the lease. [R. 39, 40.]

6. Based upon the above, the trust instrument in question was drafted and signed. It was simple in the extreme. There was no name, no seal, no office, no principal place of business, no provision for removing or replacing trustees, no meeting of trustees or beneficiaries was provided for. The beneficiaries never held a meeting of any kind. There were no officers and no board of directors. [R. 35, 41.]

7. The instrument provided that the Hub Oil Company and Bailes should receive percentages of gross production, whereas all those investing money received percentages based upon net production. Hub Oil and Bailes were not beneficiaries in the same sense as were those who put in cash, but were the owners of overriding royalties. They apparently participated, however, in the proceeds of the sale of the lease. The Hub Oil Company was also a creditor in case a producing well was brought in. [R. 37, 41.]

8. A producing well was brought in in 1925. The *entire* proceeds of production, after the payment of expenses, were distributed to the various beneficiaries. [R. 40.] No depreciation or depletion reserve was ever set up or maintained.

9. Whether or not certificates of beneficial interests were ever issued to the Hub Oil Company and/or Bailes does not appear from the record.

10. But one lease was acquired and but one well was drilled. The trust indenture provided for but one lease and one well. [R. 36, 41.]

11. The proceeds of production were paid to a bank and were by it actually handled and disbursed. [R. 40.]

12. According to the record the beneficiaries were totally inactive and neither exercised nor had the power to exercise any sort of control over the trust.

13. The record does not show what the activities of the trustees actually were. It may be assumed that they were slight, as Bailes was required to drill the well and superintend all operations until the well was on a commercial production basis. *There was apparently nothing done or to be done by the trustees except to furnish the money for the drilling operation and to later negotiate, in conjunction with other percentage owners, the sale of the lease.*

Such activities as were indulged in by the trustees are set forth in the "Statement of Evidence." [R. 34 to 36.]

14. In 1926 the lease was sold and the gross proceeds distributed. While the record does not specifically indicate either way, the presumption seems inescapable that the proceeds were distributed *pro rata* to all interested parties, including the Hub Oil Company and Bailes. Immediately after the sale the trust was terminated. [R. 35.]

15. No money was ever borrowed in behalf of the trust and no activities other than those already detailed were ever engaged in.

Reasons Why the Writ Prayed for by Petitioner Should Be Denied.

1. In his petition the petitioner alleges the existence of much confusion in the cases involving the above-named issue. If by confusion petitioner means that the decided cases covering this subject are not easily reconcilable *in result*, we agree. Such confusion, however, arises, we submit, from the application of reasonably uniform rules of law to different and varied sets of facts. It cannot be expected under such circumstances that different courts, even though applying the same rules of law, would reach identical conclusions.

Petitioner has failed to point out any real confusion as to the rules of law applicable to the issue with which we are here concerned. Confusion appears to petitioner to exist because he has refused to accept the definition of an association as adopted by this Court in *Hecht v. Malley*, 265 U. S. 144, 44 S. Ct. 462 (1924), and *Burk-Waggoner Oil Ass'n v. Hopkins*, 269 U. S. 110, 46 S. Ct. 48 (1925). In both of the above cases the Court held that an unincorporated body did not constitute an association taxable as a corporation unless in addition to doing business it was organized and operated along the forms and methods used by incorporated bodies.

It may be that petitioner desires this Court to so elaborate its views on this subject that hereafter lower tribunals may without difficulty reach a correct result in the many cases coming before them. If this is possible we would welcome it. We do not believe that this Court will attempt so to do.

2. There is no real conflict with respect to the issue herein involved between various Circuit Courts of Appeal.

The various Circuit Courts of Appeal in the United States have practically uniformly adopted the dual test already referred to as to what constitutes an association, namely, (1) doing business, and (2) organization and operation along the forms, modes, and methods ordinarily employed by corporations. Whatever differences which may have originally existed as to the legal principles properly applicable have now been virtually eliminated. This dual test has been applied by various Circuit Courts in the following recent cases: *Lucas v. Extension Oil Company*, 47 F. (2d) 65 (1931), Fifth Circuit; *Commissioner v. Brouillard*, 70 F. (2d) 154 (1934), Tenth Circuit; certiorari denied sub. nom. *Helvering v. Pryor & Lockhart Development Co.*, 293 U. S. 574, 55 S. Ct. 85 (1934); *Reinecke v. Kaempfer*, 72 F. (2d) 469 (1934), Seventh Circuit; certiorari denied January 21, 1935, 55 S. Ct. 405; *Commissioner v. Kelley*, 74 F. (2d) 71 (1934), First Circuit; also *Coleman-Gilbert Associates v. Commissioner*, 76 F. (2d) 191 (1935), First Circuit; certiorari applied for May 27, 1935, Nos. 78 and 79, October Term, 1935.

It is alleged by the petitioner herein that the decision of the Ninth Circuit Court of Appeals in the instant case is in substantial conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Swanson v. Commissioner*, 76 F. (2d) 651 (1935); certiorari applied for June 7, 1935, No. 108. We deny the conflict alleged by petitioner. It is true that the two Circuit Courts of Appeal reach different conclusions. It is also true, however, that different sets of facts were involved. It is submitted, however that *each court applied the same legal principles to the solution of the problem before it.*

Petitioner asserts that the decisions of the Circuit Court of Appeals for the Ninth Circuit in the instant case is in conflict with its prior decision in *Morrissey v. Commissioner*, 74 F. (2d) 803 (1934); taxpayer's petition for certiorari granted May 13, 1935, No. 17, October Term, 1935. With petitioner's contention in this respect we agree, although the facts involved in the two cases are essentially different. While we do not assert that the decision finally arrived at by the Ninth Circuit Court of Appeals in the *Morrissey* case was erroneous, we do believe the Court erred in failing to consider whether or not the trust in that case operated along the forms, modes, and methods ordinarily employed by corporations. The fact that the Court in that case failed to apply the proper legal tests to the problem before it constitutes the reason, we assume, why this Court granted certiorari. It does not follow, however, that the Ninth Circuit Court's subsequent decision in the instant case *in which that test was applied*, was wrong and that certiorari is hence here justified.

Wherefore, it is respectfully submitted that the petition herein prayed for should be denied.

LATHAM, WATKINS & BOUCHARD,

DANA LATHAM,

MILLER, CHEVALIER, PEELER & WILSON,

MELVIN D. WILSON,

Attorneys for Respondents.

August, 1935.

COPY

IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1935.

No. 238

[illegible], Commissioner of Internal Revenue,

Petitioner,

vs.

[illegible] Combs and Edward Everett, Trustees of L. E. Combs Well No. 1, Express Trust,

Respondents.

Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE RESPONDENTS.

[illegible]

Title Guarantee Bldg., 411 W. Fifth St., L. A.,

[illegible]

Title Ins. Bldg., 433 S. Spring St., Los Angeles,

Counsel for Respondents.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1935.

No. 238

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust,

Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE RESPONDENTS.

PRELIMINARY STATEMENT.

Petitioner contended before the Board of Tax Appeals that respondents constitute an association taxable for income tax purposes as a corporation for the years 1925 and 1926. The Board denied petitioner's contention and held respondents taxable *not* as an association but as a trust. The Board in arriving at its decision said:

"There was but one and that a very limited enterprise. The beneficiaries had no power or control. *In none of the essential elements did the petitioner resemble a corporation either in form or operation.*" (Italics ours.) [R. 25.]

An appeal from the Board's decision was taken by petitioner to the Circuit Court of Appeals for the Ninth Circuit. That Court affirmed the decision of the Board, following in general the reasoning of the Board.

The same general question with which we are here concerned is involved in *Morrissey et al., Trustees, v. Helvering,* No. 17, October Term, 1935; in *Helvering v. Coleman-Gilbert Associates,* No. 78 and No. 79, October Term, 1935; and *Swanson et al. v. Helvering,* No. 108, October Term, 1935.

Petitioner in his brief herein has embodied by reference the contentions made by him in his briefs now on file with this Court in the above-mentioned cases. It is necessary for respondents herein, therefore, to refer to contentions made by the petitioner in said other cases referred to above.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 11th, 1935. [R. .....] A petition for a writ of certiorari was filed by petitioner July 11th, 1935, and was granted October 14th, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13th, 1935.

Statutes and Regulations Involved.

The Revenue Act of 1926, c. 27, 44 Stat. 9, applicable to the years herein involved, provides in part:

"Sec. 2 (a) When used in this Act—

. . . . . .

"(2) The term 'corporation' includes associations, joint-stock companies, and insurance companies. (U. S. C. App., Title 26, Sec. 1262.)"

The Regulations with which we are here concerned, namely, Articles 1502 and 1504 of Regulations 65 and 69, issued under the Revenue Acts of 1924 and 1926, are set forth in full in Appendix "A" to respondents' (petitioner herein) brief in *Morrissey et al., Trustees, v. Helvering*, No. 17, and need not be here repeated.

Petitioner's Contentions.

Petitioner herein contends that the decision of the Circuit Court of Appeals in this case should be reversed; that respondents did constitute an association taxable as a corporation for the calendar years 1925 and 1926. This contention is predicated upon the following specific propositions:

(a) That the sole test applicable in determining whether or not a trust is an association taxable for income tax purposes as a corporation is the "doing business" test (Resp. Brief, *Morrissey et al., Trustees, v. Helvering*, p. 6); that organization and operation in the manner and methods ordinarily adopted by corporations *is not essential to the existence* of an association.

(b) That if anything more than mere business activity is required, then such additional requirement is fulfilled if there exists *centralized control, continuity of existence, and limited liability.* (Resp. Brief, *Morrissey et al., Trustees, v. Helvering,* p. 7.)

Respondents' Contentions.

Respondents contend that they do not constitute an association taxable as a corporation. This contention is grounded upon two simple propositions:

(a) That an association subject to income tax as a corporation cannot exist unless *in addition to* business purpose there is *organization and operation* along the modes, methods, and manners ordinarily adopted by corporations.

(1) That any rule other than that above referred to would inevitably destroy the classification provided for by all Revenue Acts of various taxable entities; would produce uncertainty among taxpayers bordering on chaos; and instead of simplifying problems of taxation would result only in additional confusion.

(b) That respondents herein were neither organized nor did they operate in any sense of the word along the modes, methods, and manners ordinarily employed by corporations.

Statement of Facts.

Petitioner in his brief, pages 4 to 7, has fairly and fully stated the facts. We desire, however, to restate them briefly, drawing therefrom certain inferences which we submit are fully warranted:

(1) The Hub Oil Company was the owner of a certain oil lease subject to a royalty reserved to the lessor. [R. 35, 40.]

(2) One Combs, acting apparently with one Everett, desired to finance and drill *one* well on the property in conjunction with the Hub Oil Company and one Bailes. [R. 36-41.]

(3) *Prior* to the creation of the trust herein involved, Combs and Everett entered into an agreement with Bailes whereby Bailes was to furnish drilling equipment, drill pipe, drilling materials, and *to superintend the drilling and production operations until the well should be on commercial production.* For this Bailes was to receive 12% of the gross proceeds of the well. [R. 37.]

(4) The Hub Oil Company was to furnish a derrick, boilers, gas trap, etc. In case a producing well was brought in, the Hub Oil Company was to be paid the fair value of the property furnished. In case the project was unsuccessful, the Hub Oil Company had the right to remove the equipment from the property. As a matter of fact, from production the Hub Oil Company did receive for the equipment $15,000. In addition, the company reserved a percentage of the future gross production of the well. [R. 35, 37.]

(5) All the elements necessary in order to complete a producing well were thus provided for *in advance,* except the cost of labor, casing, and incidentals. These were to be furnished in one or both of two ways:

(a) Percentage interests in future gross production of the well less *pro rata* expense deductions were to be sold. [R. 38.]

(b) Such portion of the percentage of gross production retained by Combs personally as might be necessary was to be later sold by Combs in case the proceeds of the first sales of beneficial interests were insufficient. The proceeds of such sales were to be used for trust purposes and were not to revert to Combs personally. In effect, Combs *was required* to dispose of his entire personal interest and donate the proceeds back if necessary in order to prove the lease. [R. 39, 40.]

(6) Based upon the above, the trust instrument in question was drafted and signed. It was simple in the extreme. There was no name, no seal, no office, no principal place of business, no provision for removing or replacing trustees, no meeting of trustees or beneficiaries was provided for. The beneficiaries never held a meeting of any kind. There were no officers and no board of directors. [R. 35, 41.]

(7) The instrument provided that the Hub Oil Company and Bailes should receive percentages of gross production, whereas all those investing money received percentages based upon net production. Hub Oil and Bailes were not beneficiaries in the same sense as were those who put in cash, but were the owners of overriding royalties. They apparently participated, however, in the proceeds of the sale of the lease. The Hub Oil Company was also a creditor in case a producing well was brought in. [R. 37, 41.]

(8) A producing well was brought in in 1925. The *entire* proceeds of production, after the payment of expenses, were distributed to the various beneficiaries. [R.

40.] No depreciation or depletion reserve was ever set up or maintained.

(9) Whether or not certificates of beneficial interests were ever issued to the Hub Oil Company and/or Bailes does not appear from the record.

(10) But one lease was acquired and but one well was drilled. The trust indenture provided for but one lease and one well. [R. 36, 41.]

(11) The proceeds of production were paid to a bank and were by it actually handled and disbursed. [R. 40.]

(12) According to the record the beneficiaries were totally inactive and neither exercised nor had the power to exercise any sort of control over the trust.

(13) The record does not show what the activities of the trustees actually were. It may be assumed that they were slight, as Bailes was required to drill the well and superintend all operations until the well was on a commercial production basis. *There was apparently nothing done or to be done by the trustees except to furnish the money for the drilling operation and to later negotiate, in conjunction with other percentage owners, the sale of the lease.*

(14) In 1926 the lease was sold and the gross proceeds distributed. While the record does not specifically indicate either way, the presumption seems inescapable that the proceeds were distributed *pro rata* to all interested parties, including the Hub Oil Company and Bailes. Immediately after the sale the trust was terminated. [R. 35.]

(15) No money was ever borrowed in behalf of the trust and no activities other than those already detailed were ever engaged in.

ARGUMENT.

I.

Unless This Trust (A) Carried on Business for Profit and (B) Upon the Forms and Under the Modes and Methods Ordinarily Employed by Corporations, It Cannot Be Treated as an Association Taxable as a Corporation.

In this subdivision of our argument we will state what we believe the law of this case to be. It will be followed by a statement of the reasons why we consider such to be the law. We will also point out the results which we sincerely believe *must* follow the adoption of petitioner's contentions herein.

Before taking up our argument in chief, certain points are worthy of note:

(1) We are not here concerned with an excise tax levied against a corporation for the privilege of doing business. *Flint v. Stone Tracy Co.*, 220 U. S. 107, 31 S. Ct. 342 (1911), is not therefore directly in point.

(2) We are not here concerned with a stamp or capital stock tax. *Hecht v. Malley*, 265 U. S. 144, 44 S. Ct. 462 (1924).

(3) We are here concerned with an *income tax* for the calendar years 1925 and 1926.

The distinction, we submit, is important. Excise and capital stock taxes have, without exception, been levied against only one kind of taxable entity, namely, corporations. From the beginning our *Federal Income Tax Acts* have contemplated a number of dif-

ferent taxable entities including individuals, partnerships, trusts, estates, and corporations.

(4) Petitioner's contentions herein, if sustained, mean additional income taxes to the persons interested in this trust. The provisions of the 1924 Revenue Act taxing trusts, treat such trusts and the beneficiaries thereof as individuals. As such they are subject to the normal and the surtax provided by law. Under petitioner's contentions the corporate rate would be exacted from the trust as an entity. Distributions by the trust would then be taxed to the beneficiaries as dividends and would be subject to the surtax but exempt from the normal tax. The result is to increase the taxes due from the parties interested by the difference between the corporate and the normal tax rate for the years in question. This difference in favor of the Government is substantial.

(5) We are not here dealing with a case in which respondents seek to avoid the payment of any tax imposed against trusts or the beneficiaries thereof as such. So far as the record shows respondents filed returns and paid the taxes levied against trusts and the beneficiaries thereof by the applicable Revenue Act. Petitioner seeks to lift these persons out of the classification in which they believed they belonged and place them in another and more costly group.

Turning now to what we earnestly believe to be the *law of this case*, we submit the following:

(1) In no Revenue Act is the term "association" specifically defined.

(2) The term "association" as used in the various Revenue Acts was early held to be therein used in its *ordinary meaning.* In *Hecht v. Malley, supra,* in which the Acts of 1916 and 1918 were involved, this Court said, on page 157:

> "The word 'association' appears to be used in the Act in its ordinary meaning."

The Board of Tax Appeals has uniformly so held. *Philadelphia & Reading Relief Association,* 4 B. T. A. 713 (1926). This general rule of usage was very recently reaffirmed by the Tenth Circuit Court in *Commissioner v. Brouillard,* 70 F. (2d) 154 (1934).

(3) It is next important to determine what the *ordinary meaning* of the term *association* is. From this meaning we derive the tests heretofore referred to as to what constitutes an association. This meaning seems well established.

> "In the United States this term is used to signify a body of persons united without a charter but upon the methods and forms used by incorporated bodies for the prosecution of some enterprise." 1 Bouvier's Law Dictionary (Raule's Third Revision) 269.

In *Hecht v. Malley, supra,* this Court approved the above definition almost *verbatim:*

> "It (association) has been defined as a term 'used throughout the United States to signify a body of persons united without a charter but upon the forms and methods used by incorporated bodies for the prosecution of some common enterprise, . . .'"

Subsequently this Court reaffirmed the definition adopted in the *Hecht* case and specifically pointed out the necessity for quasi-corporate form of organization and operation. See *Burk-Waggoner Oil Asso. v. Hopkins,* 269 U. S. 110, 46 S. Ct. 48 (1925). In that case this Court said (p. 113):

> "Unincorporated joint-stock associations although technically partnerships under the law of many states, are not in common parlance referred to as such. They have usually a fixed capital stock divided into shares represented by certificates transferable only upon the books of the company; manage their affairs by a board of directors and executive officers and *conduct their business in the general form and mode of procedure of a corporation. Because of this resemblance in form and effectiveness these business organizations are subjected by the Act to these taxes as corporations.*" (Italics ours.)

Regardless of the specific applicability of the decisions of this Court in the cases of *Crocker v. Malley,* 249 U. S. 223, 39 S. Ct. 270 (1919); *Hecht v. Malley, supra;* and *Burk-Waggoner Oil Asso. v. Hopkins, supra,* it is submitted without qualification that in those cases this Court (a) adopted and approved the long accepted definition of the term "association," and (b) applied this definition to the Federal Revenue Acts with which this Court was there concerned.

Since 1925 this Court has not spoken on this point with respect to *income tax liability.* We know of no reason why this Court in the cases now pending before it should depart from the principles heretofore enunciated.

The Board of Tax Appeals has likewise repeatedly and *uniformly* applied the ordinary meaning test above referred to in determining whether or not a trust constitutes an association. In *Fred T. Murphy et al., Trustees,* 25 B. T. A. 724 (1932), the Board said:

> "An 'association' is an unincorporated body of persons organized in the general form of a corporation and employing corporate methods in carrying on a business for profit."

In *Morriss Realty Trust No. 1,* 23 B. T. A. 1076 (1931), the Board, in defining an association, said:

> "There is a triple test involving (a) business purpose; (b) business operations; and (c) quasi-corporate structure."

We submit that the principles laid down by this Court in the three cases heretofore referred to have been followed with practical unanimity by the various Circuit Courts of Appeal which have had occasion to pass on this question. If in the beginning any doubt existed as to the application of the *dual test* of business purpose and organization and operation along the modes, methods, and manners of a corporation contended for by respondents, then that doubt has been recently resolved against petitioner and in favor of respondents.

Respondent (petitioner herein) in Appendix "B" to his brief in *Morrissey et al., Trustees, v. Helvering,* No. 17, refers to certain decisions of various Circuit Courts. On page 20 of said brief he admits that the Circuit Courts of Appeal for the First, Fifth, Seventh, and Tenth Circuits have insisted upon said dual test. It is also admitted that since the decision of the Ninth Circuit in the instant

case it may be assumed that that Circuit has adopted the majority view.

Petitioner contends, however, that the Circuit Courts of appeal for the Second and Third Circuits have "consistently relied upon the business test as conclusive." (Resp. Brief, *Morrissey et al., Trustees, v. Helvering,* p. 20.) With this contention we do not agree.

In the case of *Allen v. Commissioner,* 49 F. (2d) 716 (1931), certiorari denied 284 U. S. 655, 52 S. Ct. 34 (1931), the Circuit Court of Appeals for the Second Circuit simply held that the trust in question was not engaged in business. There was hence no occasion for it to determine whether or not the trust was organized and operated along the modes, methods, and manners ordinarily employed by corporations.

In *Ittleson v. Anderson,* 67 F. (2d) 323 (1934), a capital stock tax case, the Second Circuit apparently recognized the requirement for quasi-corporate form. In rejecting of the contention that an association could not there exist because the trust had but one beneficiary, the Court said:

> "Usually there are a number of beneficiaries in a business trust, but there is no reason to say that every business trust must have more than one beneficiary at all times. *This tax is a special excise on the privilege of doing business in a certain form. The test is whether or not business is being conducted in a quasi-corporate form.*" (Italics ours.)

Respondent (petitioner herein) also refers in his Appendix "B" to said Morrissey brief to the decision of the Board of Tax Appeals in *Investment Trust of Mutual Investment Co. v. Commissioner,* 27 B. T. A. 1322 (1933),

affirmed *per curiam* by the Second Circuit Court, 71 F. (2d) 1009 (1934). It is significant to note that the Board in its opinion said, page 1328:

> ". . . there are three tests for determining whether an organization is to be classified as one or the other: (1) business purpose; (2) business operations; (3) quasi-corporate structure."

We likewise submit that the Third Circuit Court of Appeals has recognized the dual test herein contended for. In *Little Four Oil & Gas Co. v. Lewellyn,* 35 F. (2d) 149 (1929), certiorari denied 280 U. S. 613, 50 S. Ct. 162 (1930), the Third Circuit Court in the concluding paragraph of its opinion said:

> ". . . the Collectors were right in regarding this organization, however named, as an unincorporated association conducting a business for profit in *quasi-corporate form* . . ." (Italics ours.)

In *Smith v. Commissioner,* 69 F. (2d) 911 (1934), certiorari denied 293 U. S. 561, 55 S. Ct. 73 (1934), the Third Circuit Court said:

> "The test laid down by this Court in Little Four Oil & Gas Co. v. Lewellyn . . . is that if the trust is a business concern and if the shareholders or trustees, or both combined are operating it in active business for profit, the trust is in effect an association taxable as a 'corporation.'"

The term "business concern," we believe, specifically contemplates quasi-corporate organization.

It is submitted that the Second and Third Circuit Courts have in fact recognized in association cases the dual test theory contended for by respondents.

If any Circuit Court has in the past relied upon business purpose as the sole test, it was the Ninth Circuit in the decisions handed down by it prior to that in the instant case. Since that Circuit in the instant case recognized the dual test here contended for, we believe that practical unanimity among the various Circuits on this question now exists.

Not only have the courts adopted the dual test and dual requirement above referred to, but the most authoritative text writers, after careful examination of all applicable law, have come to the same conclusions. In *Paul & Mertens Law of Federal Income Taxation*, Callaghan & Co., 1934, volume 4, page 249 *et seq.*, it is said:

> "Probably the two most important considerations in determining whether a particular organization is taxable as an association are:
>
> (1) the character of the organization's activities, often called the 'profit' test, and
>
> (2) whether it has a quasi-corporate form and mode of procedure.
>
> "Where both requirements are present the organization is taxable as an association. These requirements may on occasion blend and become largely indistinguishable. *The second element must, however, be present.* A large number of trusts, joint ventures and partnerships would be taxed as corporations, if the only test was whether the entity was carrying on business for profit. . . ." (Italics ours.)

It is submitted that the *law of this case* is clear. A trust is not an association taxable for income tax purposes as a corporation unless there exists (a) business purpose,

and in addition (b) organization and operation along the modes, methods, and manners ordinarily employed by corporations.

We may turn now to a consideration of the Regulations issued by the Commissioner of Internal Revenue under the various Revenue Acts. These Regulations petitioner contends are in accordance with the statute and have, through constant readoption, established the single test theory asserted by him.

(1) It is submitted that these Regulations, even though they may, in general, follow the statute, will be of little assistance to the Court in its interpretation thereof.

The Regulations issued under the various Acts have lacked that uniformity of interpretation necessary in order to lend to them the weight of law. This fact is best evidenced by an examination of the various Treasury Regulations issued in connection with the so-called "control" theory. Article 1504 of Regulations 45 issued under the 1918 Act in defining an association and distinguishing it from a trust said nothing about control as such. The only mention thereof was indirect and appears in the last sentence of that Article, as follows:

> "If, however, the *cestui que trust* have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute."

The same Article was reenacted without change in Regulations 62 issued under the Revenue Act of 1921. In 1924, however, after the decision of the Supreme Court in the *Hecht* case, the Treasury Department amended Regulations 65 issued under the Revenue Act of 1924 to provide

that in case of control by the beneficiaries of a trust, an association existed and that even in absence of control an association existed in certain other cases. As was pointed out by the Treasury Department in a brief filed with the Ninth Circuit Court in the case of *Sloan v. Commissioner*, 63 F. (2d) 666 (133):

> "The entire administrative viewpoint was changed by the decision of the Supreme Court in *Hecht v. Malley*, 265 U. S. 144."

Here we have the origin of the control theory which has troubled the courts and Treasury for so many years.

Regulations 65 as above amended were re-enacted in Regulations 69 and 74 issued under the 1926 and 1928 Acts respectively.

In the meantime, however, various courts had questioned the soundness of the so-called "control" test. Typical was that of the First Circuit in *White v. Hornblower*, 27 F. (2d) 777 (1927), where the Court said:

> "The powers of the certificate holders . . . are significant only as they tend to show whether what the interested parties did amounted to forming themselves into an association . . ."

Accordingly, when Regulations 77 were issued under the Revenue Act of 1932, all reference to control as a test was eliminated. In other words, the *Treasury Department without any statutory change whatsoever has abandoned entirely the control theory.*

The above recital demonstrates clearly the fallacy of lending too great legal weight to Administrative Regulations. If the Regulations issued under the 1928 Act and defining control are to be deemed the equivalent of law,

then the Secretary of the Treasury without statutory authority himself changed the law when he issued the 1932 Regulations which made no mention of control. Obviously this cannot be true.

The Regulations, it is submitted, can in no event amount to more than the Treasury's interpretation of the statute as Congress enacts it. This was pointed out without qualification by the First Circuit Court in *Commissioner v. Kelley*, 74 F. (2d) 71 (1934), where the Court said:

> "No absolute rule of such classification has yet been laid down by the Supreme Court and the Regulations of the Treasury Department, 74, Art. 1314, cannot be held to be exclusive in defining the line between a trust and an association."

(2) As a matter of fact, the Regulations in effect during the years 1925 and 1926 must be deemed to fully recognize the two-fold test contended for by respondents. The Regulations in effect during those years are admittedly based upon the decision of this Court in the *Hecht* case, *supra*. The *Hecht* case admittedly employs the dual test of business purpose and quasi-corporate form of organization and method of operation.

Nor are the Regulations as actually drafted for those years in conflict with the principles herein contended for. Article 1502 of Regulations 45, issued under the Act of 1918, provides in part:

> "Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known which act or do business in an *organized* capacity, . . . the net income of

which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds. . . ." (Italics ours.)

The above provision has been readopted without substantial change in all subsequent Regulations down to and including the Regulations issued under the 1932 Act. It is submitted that the above definition recognizes both the business and the quasi-corporate form of organization and method of operation tests although it probably underemphasizes the importance of the latter. Had these Regulations confined themselves to the Article just quoted, which was simply a definition of the word "association," much of the confusion of the last ten years might have been avoided.

The difficulties into which the Treasury and the courts have fallen have been due in the main, it is submitted, to the Treasury's attempt in subsequent Articles of the same Regulations to *distinguish associations from other taxable entities such as partnerships and trusts.* (See Articles 1503 and 1504 of Regulations 45 and similar Articles of subsequent Regulations.)

An examination of the various Regulations issued by the Treasury Department in which the term "association" is defined or distinguished, indicates beyond doubt a tendency to widen the field of application of that term, which tendency has increased greatly with the passing years. (Compare Articles 1502 and 1504 issued under the Revenue Act of 1924 with Articles 801-2 and 801-3 of Regulations 86 issued under the Revenue Act of 1934, respondent's (petitioner herein) brief, *Morrissey et al., Trustees, v. Helvering,* No. 17.)

II.

To Apply the Test Contended for by Petitioner Is to Destroy the Long Established Statutory Distinction Between Taxable Entities and to Produce Further Confusion Among Taxpayers.

In the discussion which follows we propose to examine petitioner's contentions with a view to determining if possible:

(1) Whether or not they are sound and consistent with established concepts of Federal income taxation.

(2) Whether or not their application will result in the simplification of what is admittedly a difficult problem of interpretation and administration.

We submit without qualification, (1) that the petitioner's theories with respect to the taxability of this trust as an association are totally at variance with long established income tax concepts, and (2) that these theories, if applied, instead of simplifying our present problem will result in even greater confusion.

(1) With regard to the first of the above points we believe the following to be true:

(a) That petitioner's contention that business purpose alone transforms a trust into an association, is contrary to the classic common law conception of the term "association."

(b) That it results in increased income tax liability without clear or specific statutory authority therefor. It is too well established to require comment that taxing statutes, in case of doubt, are to be most strongly construed against the Government and in favor of the taxpayer. *Gould v. Gould*, 245 U. S. 151, 153, 38 S. Ct. 53 (1917).

This point is vital and worthy of further elaboration. Since 1913 all Federal Revenue Acts *for income tax purposes* have specifically provided for a number of *different* taxable entities. Among these different entities are individuals, trusts, estates, partnerships, and corporations. Each statute has provided for a specific method of taxing each entity. Each statute has provided certain rights, liabilities, and exemptions for each entity, and these rights, liabilities, and exemptions have differed as the entities have differed.

Section 219 of the Revenue Act of 1926 provides in part:

> "(a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of *any kind of property held in trust, including*—
>
> "(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;
>
> "(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;
>
> "(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and
>
> "(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated." (Italics ours.)

Petitioner contends that the above Section of the statute is intended to apply only to trusts which are "engaged merely in collecting the income and conserving the property against the day when it is to be distributed to the beneficiaries." (Resp. Brief, *Morrissey et al., Trustees, v. Helvering*, p. 6.)

In making this contention, the petitioner points neither to statutory language nor legislative history. It is submitted that his contention in this particular is without foundation. In ten Revenue Acts and over a period of more than twenty years the statutory provisions with respect to trusts have remained more or less constant. It would have been exceedingly simple for Congress to have limited by statute the application of the trust provisions of the various Acts to the class of cases referred to by petitioner. Instead, the provisions of the statute with respect to trusts have remained almost identical.

It is contended by petitioner that the term "corporation" is defined in the Revenue Act of 1926 as "including associations, joint stock companies, and insurance companies," and that this definition applies wherever that term appears in said Act. We submit that this position is entirely untenable.

If the petitioner's contention in this respect is sound and a trust engaged in business is subject to tax as a corporation, then said trust should be subject to all the other provisions of statute governing corporations. *But this cannot be true.* A few examples only are necessary:

(1) Section 220 of the Revenue Act of 1926 imposed heavy penalties on corporations which permitted their surplus to accumulate beyond the

reasonable needs of the business. All Revenue Acts have contained similar provisions. It is too well known to require comment that some trusts which are not merely "dry" trusts were formed for the very *purpose* of accumulating income. Yet the Treasury Department has never attempted to apply these penalty provisions of the statute to accumulations of such trusts, regardless of whether or not they were engaged in business.

(2) Section 203 of the Revenue Act of 1926 contains many complex provisions governing the reorganization of corporations. Other Acts have contained similar provisions. There is no provision in that Section exempting its application to trusts which may constitute associations. If a trust is a corporation for the purpose of the income tax, no good reason exists why it should not be a corporation for the purpose of the statutory provisions relative to the reorganization of corporations. Yet the Treasury has never applied these provisions of law to anything except corporations formed under the laws of some particular sovereignty. It is too obvious to require comment that to attempt to apply these provisions of the statute to a trust such as we are here dealing with would involve all parties in utter confusion.

These instances might be multiplied. It is believed that it is unnecessary to make further reference to the petitioner's own inconsistency in applying his concept of an association to all of the varied problems which arise under our Revenue Acts.

What has heretofore been said has had special reference to trusts. It is, however, equally applicable to estates, partnerships, and joint adventures. They all engage in *business*. There is no reason why the petitioner's test as to what constitutes an association should be applied to trusts and ignored with respect to the other taxable entities referred to above.

If the matters which we have here undertaken to emphasize have any merit, it must be this: *The petitioner has no right to lift out of the classification as a trust, the entity with which we are here concerned and place it in another specific statutory classification and tax it as a corporation, unless the statute clearly so provides.* We sincerely believe that the above principle is sound. We believe that it was approved by this Court in *Crocker v. Malley, supra,* when the Court, in refusing to tax a Massachusetts trust as an association, said:

> "This opinion is based primarily upon the view that the Income Tax Act, considering its purpose, did not show a clear intention to impose upon the trustees, as an 'association,' a double liability in reference to the dividends on stock in the corporation that itself paid an income tax, *when, considered, as 'trustees', they were, by another provision of the Act, exempt from such payment.* . . ." (Italics ours.)

The above case has been repeatedly cited and often misconstrued. We submit, however, that it stands squarely for the principle of statutory construction set forth and is clearly applicable to cases such as the one at bar.

We submit that petitioner in contending that a trust is taxable as an association if it engages in business, regardless of the method of organization or the manner in which it conducts its business, is contending for a principle that is both unsound and unreasonable.

But petitioner himself does not have implicit faith in his position. (Resp. Brief, *Morrissey, et al., Trustees v. Helvering*, p. 21.) Petitioner suggests that the requirements as to form and method of operation, however, are met where there exists "some or all of the elements of centralized control, limited liability, and continuity of business."

We do not accept the above as complying with the second of the tests laid down for the existence of an association. *They do not go far enough.* Centralized control and continuity of business existence are more or less present in all partnerships and all trusts. In most "dry" trusts the beneficiaries may sell or encumber their beneficial interests. In practically all trusts centralized control lies with the trustees. Most partnerships have a managing partner, while in all partnerships involving "silent" partners, the general partners have control.

Limited liability is provided for in many instruments, yet it may exist only in the minds of the parties thereto. Limited liability does not exist and is not an advantage unless it exists *in fact and in law.* This Court may take judicial notice of the fact that many unincorporated groups have thought limited liability applicable to them but found to their sorrow that in law it did not exist. Except in rare instances, limited

liability *in law* exists only in the case of statutory corporations.

Finally, petitioner contends that we must not sacrifice substance to form; that what respondents herein are contending for are matters of form. *But we believe these matters of form are in this case matters of substance.* Petitioner, we submit, would destroy substance by merging in one all taxable entities involving more than one person where business is a feature. We insist that the *form* of the various Revenue Acts must be preserved. This form can only be preserved if the taxable entities therein provided for are maintained.

We believe that not only is the petitioner wrong in contending that business purpose is the sound test in fixing the identity of an association, but we believe that he is wrong in contending that quasi-corporate form and method of operation is satisfied if there exists centralized control, limited liability, and continuity of business existence.

(2) We have but one more problem to consider in connection with petitioner's contentions: If adopted by this Court will they simplify the administration of our taxing statutes. We submit that his contentions, if followed, instead of simplifying our problem will add confusion to confusion.

If we assume that all trusts are subject to tax as associations, provided only there exists a "business purpose," there remains the very troublesome question as to what constitutes "doing business." The complexity of that problem is too well settled to require elaboration here.

But even if that problem can be satisfactorily answered, there remains the question as to how far this test will be extended and to what entities it will be applied. As heretofore pointed out, if doing business is the sole test there is no reason why it should be limited in its application to trusts. As the need for revenue grows the Treasury will undoubtedly seek to extend the principle to partnerships, estates, and joint adventures. The constantly increasing number of cases in which a group of individuals has been found by the Treasury to constitute an association taxable as a corporation is the best evidence of the truth of this assertion.

The result would mean chaos and utter confusion in the ranks of taxpayers. It would mean that the Treasury Department could come back at any time against any entity which it deemed an association and tax it as such. The statute of limitations would be no bar because no return as a corporation would have been filed by said entity. If the Treasury were successful in its contention, a tax as a corporation could be collected from said entity at a time when the persons interested therein could not recover because of the statute of limitations any prior overpayment of taxes resulting from this change of classification. The situation which might develop is not only confusing; it is fraught with danger.

Nor does petitioner's contention that the requirement of corporate form and method of operation is satisfied by centralized control, limited liability, and continuity of business, solve the problem. It is difficult to conceive of elements more intangible in nature or difficult of interpretation than those just mentioned.

To say that a trust to be taxable as an association must in addition to doing business be organized and operated

along the modes, methods, and manners of a corporation does not impose an undue burden on our courts. All courts and all lawyers are familiar with the modes, methods, and manners of corporations. To apply that criterion to a given case involves no more difficulties than arise constantly in other cases. Certainly it would seem easier to apply that test than the tests contended for by petitioner.

It is submitted that the theories contended for by petitioner are not only unsound and inconsistent with our established body of tax law, but would involve the taxpayers of the country, as well as the administrative officials of the Treasury Department, in hopeless confusion.

III

This Trust Is Not an Association Because It Was Neither Organized nor Operated Along the Forms, Methods, and Manners of a Corporation.

Petitioner, in his brief, assumes that we concede that this trust was doing business. (Pet. Brief, p. 7.) Such is not the case. We do not propose here, however, to indulge in any extended argument on that point. We deem it unnecessary to a decision of this controversy.

It is submitted that our assertion that respondents herein are not taxable as an association because neither organized nor operated along the forms, modes and methods of a corporation must inevitably follow if our case is approached in the fashion adopted by the Fifth Circuit Court of Appeals in the similar case of *Lucas v. Extension Oil Company*, 47 F. (2d) 65 (1931). There the Court, in affirming a decision of the Board of Tax Appeals which had held the trust in question not to be an association, said:

"The Board of Tax Appeals in a careful opinion, balancing the resemblances which petitioner in its structure bore to a trust, against those which it bore to a corporation, and considering also the facts as to what the petitioner actually did, *found as a fact* and concluded as a matter of law that petitioner was not an association within the meaning of the taxing act 'voluntarily organized to transact business under corporate forms and transacting such business.'" (Italics ours.)

A balancing of resemblances such as above described discloses *in the instant* case an almost complete lack of corporate form of organization.

(1) Corporations ordinarily have at least three directors; even assuming that the trustees of this trust could be deemed directors, there were but two trustees. Corporate directors are elected annually by the stockholders; the trustees of this trust were appointed for the duration of the trust, and upon the death, resignation, or refusal to act of one, the remaining trustee was authorized to carry on alone. Corporations act through officers; this trust admittedly had none. Corporations have by-laws, seals, names, offices, and places of business; this trust had none of these corporate indicia. Corporate directors and stockholders have meetings and places of meeting; neither the beneficiaries nor trustees of this trust met or had places of meeting.

It is inescapable that all that happened in this case was that two trustees took title to a lease. When they acquired such title the production was subject to royalties and overriding royalties. A contract for the drilling of the well and superintending operations until commercial production was attained *had been entered into prior to the*

creation of the trust. There was nothing for the trustees to do except provide a certain amount of money for labor, casing and incidentals. After the well was on production they did not even act as fiscal agents as the Bank of Italy received and disbursed all moneys. Apparently the only thing of importance which the trustees had to do was to negotiate the sale of the lease. Even with respect to this point, in view of the fact that 29.667% of the gross production of the lease was held by other parties, it is quite apparent, although the record does not specifically disclose it, that these other parties, in addition to the trustees, had an interest in the negotiations.

In this case no provision was made for the determination of *net income* as that term is ordinarily understood in an accounting sense. There was no provision for a depreciation or depletion reserve. Instead, the entire production less necessary operating expenses was immediately distributable and was actually distributed.

Within a year after the well came into production, the lease was sold and the gross proceeds were distributed *pro rata* not only to the beneficiaries but so far as the record shows to the other persons interested in the lease.

In this case there *was not a continuous business venture.* Instead, there was involved only the liquidation of a wasting asset under a single lease. Only one well and one lease was provided for. Scope of activity and duration of life was necessarily limited. That continued enterprise is an important indicium of a corporation has been repeatedly recognized. In *Commissioner v. Kelley, supra,* the Court said:

"Corporate forms are used ordinarily to secure continued existence of the entity; here, the purpose was temporary, and as soon as accomplished the trust was terminated and the partnership form revived."

See, also,

Lucas v. Extension Oil Company, supra.

It is not necessary to burden this Court with further examples of corporate dissimilarities. We trust that it will not be deemed an exaggeration if we say that such dissimilarity exists with respect to every essential detail.

Petitioner contends (Brief p. 8) that continuity of existence and limited liability constitute sufficient resemblance on the part of respondents to a corporation to render them subject to tax.

We do not concede, as has heretofore been pointed out, that continuity of existence and limited liability constitute sufficient corporate resemblance to satisfy the tests required by the general law.

As we have stated, continuity of existence, as evidenced by the transferability of certificates of beneficial interest, is equally applicable to so-called "dry" trusts, which petitioners concede do not constitute associations subject to tax as corporations.

Limited liability may be provided for in the trust indenture, but it by no means follows that such liability actually exists in law and in fact. Limited liability, as that term is applied to corporations, exists only by virtue of statutory law. We have no such limited liability in this case.

The trust agreement, it is submitted, resembles a corporate charter in no fundamental particular. The powers

given the trustees are not those ordinarily provided for with respect to directors. The so-called certificates of beneficial interest do nothing more than prescribe the participation of certain of the people interested in the enterprise.

(2) With respect to *methods of operation*, it is submitted that respondents at no time conducted their activities in a manner even remotely resembling that of a corporation.

So far as this element is concerned, petitioner in his brief (p. 8) states: "The business of the trust was conducted by the trustees for the beneficiaries." There is nothing novel in this statement. We presume it to be true of every trust, of every estate, and of every partnership containing limited partners. It by no means follows that the activities of respondents herein were conducted along the modes, methods and manners of a corporation and that, therefore, they are taxable as a corporation.

It is necessary here to point out one more fact. Respondents herein *did not* resemble the entities with which this Court was dealing in *Hecht v. Malley, supra*, and *Burke-Waggoner Oil Association v. Hopkins, supra*. It would unduly prolong this discussion to point out the dissimilarities. Suffice it to say that the trust with which we are here concerned resembled the entities involved in those cases in no substantial particular.

It is not necessary to further burden this Court with a recital of the differences between this trust and the ordinary business corporation. It is sufficient to say that

counsel have examined recorded decisions involving oil trusts, both by the Board of Tax Appeals and the various Federal Courts. *We know of no case where any court or the Board has held an oil trust so lacking in corporate indicia as this to be taxable as an association.* On the other hand we feel confident that this Court will agree that in many cases the courts and Board of Tax Appeals have held oil and other trusts not to be associations where far more of the indicia of corporate form and method of operation existed than in the instant case. A few only of these cases need be cited.

In *Commissioner v. Kelley, supra,* there was a corporate name, Union Paste Company; a president and treasurer, and a clerk; a seal; the power to purchase property; a place of business; and a business susceptible of continuous operation. Nevertheless, the Court held that there was no quasi-corporate form and hence no association.

In *Commissioner v. Brouillard, supra,* the Iowa-Burk Syndicate was engaged in developing an oil lease and had corporate indicia and activities as follows: Four men owned an oil lease. They lacked capital to develop it. They formed a syndicate, naming three trustees to hold title to a one-half interest in the lease. The trustees sold interests for $30,000, entitling the 110 holders to a one-half interest in the venture. Certificates were issued to some of the holders. The certificate holders named one of the trustees. One meeting of the certificate holders was held. A bank account was kept. The syndicate kept books. A well was drilled and oil struck. Two additional

wells were drilled on borrowed money. The lease was then sold.

The Court held that the above trust was not an association taxable as a corporation.

In *Lucas v. Extension Oil Co., supra,* five men owned an oil lease; they created a trust under the name of Extension Oil Company, named four trustees, divided the trust estate into 400 units. There were seventeen beneficiaries, who contributed about $10,000. A well was drilled which produced oil. The proceeds were distributed. The following year the lease was sold and the trust terminated. A bookkeeper was employed who also handled the money. The Court held that the trust was not transacting business under "corporate forms."

In *Tyson v. Commissioner,* 68 F. (2d) 584 (C. C. A. 7th, 1934), certiorari denied 292 U. S. 657, 54 S. Ct. 865 (1934), three trustees took charge of a fund of money and purchased improved property, which was under lease. An agent was employed to collect rentals and manage the property. The trustees met. Dividends were paid every six months. The trustees set aside a depreciation fund of $5,000 which they invested in bonds. The property was sold in one of the three taxable years, after the beneficiaries had been orally consulted. A substantial profit was realized on the sale. The Court held there was no association.

In *Lansdowne Realty Trust v. Commissioner,* 50 F. (2d) 56 (1931), four trustees took title to property subject to a lease. The trust might last twenty years. The

trustees were to hold and manage the property, distribute the income, acquire other property if advisable, borrow money and employ agents, attorneys, etc. The trustees were to keep books and make reports to the beneficiaries. They were compensated for their services. A majority of the trustees could act in the absence of one. Vacancies in the office of trustee could be filled by the remaining trustees, with the written assent of the holders of a majority in amount of the beneficial interests. The Court held that this venture was not an association.

Conversely, there are comparatively few cases in which the courts or Board of Tax Appeals have held oil trusts to be taxable as associations. With one of these decisions, that of the Ninth Circuit Court in *Twin Bill Oil Syndicate v. Commissioner*, 70 F. (2d) 402 (C. C. A. 9th, 1934), reversed by this Court 293 U. S. 312, 55 S. Ct. 174 (1934), we are in full accord. We invite, however, a comparison of the corporate attributes of the Twin Bell Oil Syndicate with those of E. E. Combs Well No. 2 Express Trust. We believe that this Court will agree that there are almost no elements of essential similarity.

We submit that this trust was neither organized nor operated along the forms, methods, and manners of a corporation and therefore is not an association taxable as a corporation.

Conclusion.

The decision of the Circuit Court of Appeals for the Ninth Circuit, that the trust herein involved is not an association taxable for income tax purposes as a corporation, should be affirmed for the reasons that:

(1) The test as to whether an association exists is two-fold and requires (a) business purpose, and (b) organization and operation along the modes, methods, and manners of procedure of a corporation.

(2) The trust herein involved, even assuming that it was engaged in the transaction of business for profit, was neither organized nor operated along the forms, methods and manners of a corporation.

Respectfully submitted,

LATHAM, WATKINS & BOUCHARD,
DANA LATHAM,
MILLER, CHEVALIER, PEELER & WILSON,
MELVIN D. WILSON,
Attorneys for Respondents.

November, 1935.

SUPREME COURT OF THE UNITED STATES.

No. 238.—October Term, 1935.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioners, vs. E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 16, 1935.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The trustees of E. E. Combs Well No. 2 contested the ruling of the Commissioner of Internal Revenue that the taxpayer was taxable as an association, and not as a trust, on its income for the years 1925 and 1926. The Board of Tax Appeals sustained their contention and the Circuit Court of Appeals affirmed the order of the Board. 76 F. (2d) 682. A writ of certiorari was issued in view of the conflict of decisions to which we have referred in *Morrissey v. Commissioner*, decided this day.

The trust was created "to finance and drill a well for production and sale of oil and other hydro-carbon substances under Oil and Gas Lease dated July 24, 1924". By the agreement, the Hub Oil Company, a California corporation and owner of the oil and gas lease, assigned to E. E. Combs and Edward Everett as Trustees all its rights under the lease, subject to a reservation of 6.5 percent of all oil, gas, and other hydro-carbon substances which might be produced and of a royalty interest in favor of one Smithson of 2 percent. The agreement described as beneficiaries "All persons who may own or acquire portions of the whole beneficial interest" as defined. The assignor agreed to supply to the trustees certain equipment, and one Bailes had already agreed to furnish other equipment and materials and to superintend the operation of drilling the well in consideration of 12 percent of the production. The trust was to pay all labor claims and for materials not otherwise provided.

The "whole beneficial interest" in the trust was defined as .71333 percent of gross production, and the beneficiaries were to

be paid their pro rata shares, after deduction for the payment of lawful trust obligations, as follows: (a) 25 percent of gross production to the beneficiaries who provided money for the trust purposes, (b) .44333 percent to E. E. Combs, and (c) 2 percent to Edward Everett. Certificates of beneficial interest were to be issued in approved legal form and were to be held in escrow until a producing well was brought in. Thirteen persons were named as beneficiaries, with the amounts contributed and the percentages owned by each, these amounts aggregating $25,000 and the percentage of ownership amounting to 25 percent. The "certificate of beneficial interest" recited that the party named was the holder of a beneficial interest under the trust agreement in the amount stated and that the same was transferable only upon the books of the trustees, upon endorsement and surrender of the certificate. The trustees were authorized to hold all property and property rights, the legal title to which might vest in them under the trust, to use the moneys deposited by beneficiaries to pay for labor, casing and other materials incident to drilling and production, to manage and protect the trust property, to pay "trust debts", to sell all products of the well, to borrow money upon the credit of the trust, and to sell any "unsold beneficial interests" as they might deem best for trust purposes. The trustees were not to be individually liable except for willful misconduct. E. E. Combs was to act as production manager at a stated salary after the well was in production. All proceeds "of sale of well products" were to be paid into a designated bank to be distributed as agreed.

The provisions of the agreement were carried out. The thirteen described beneficiaries contributed the amount above stated. A well was drilled in 1925, and produced oil through the remainder of that year and for a portion of the year 1926. In the latter year the Trustees sold the lease. In both years they currently distributed to the beneficiaries the net proceeds from the sale of oil and from the sale of the lease and, after the latter sale and distribution of the moneys received, the trust was terminated.

The beneficiaries did not hold a meeting and the trust had no office or place of business, no seal, by-laws or official name, and the operations of the trustees were confined to the one lease they acquired.

In considering whether an association was created, the fact that the beneficiaries did not exercise control is not determinative.

Hecht v. *Malley*, 265 U. S. 144; *Morrissey* v. *Commissioner*, *supra*. The parties joined in a common enterprise for the transaction of business, and the beneficiaries who contributed money for that purpose became associated in the enterprise according to the terms of the arrangement. The essential features of the enterprise were not affected by the fact that the parties confined their operations to one oil well. See *Swanson* v. *Commissioner*, decided this day. Parties may form an association for a small business as well as for a large one. Here, through the medium of a trust the parties secured centralized management of their enterprise, and its continuity during the trust term without termination or interruption by death or changes in the ownership of interests, and with limited liability and transferable beneficial interests evidenced by certificates. Entering into a joint undertaking they avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain to corporate organization. The fact that meetings were not held or that particular forms of corporate procedure were absent is not controlling. *Morrissey* v. *Commissioner*, *supra*.

We think that the taxpayer was taxable as an association. The judgment is reversed and the cause is remanded for further proceedings in conformity with this opinion.

It is so ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.